



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9888]

RIN 1545-BN18

Guidance under Section 355(e) Regarding Predecessors, Successors, and Limitation on Gain Recognition; Guidance under Section 355(f)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance regarding the distribution by a distributing corporation of stock or securities of a controlled corporation without the recognition of income, gain, or loss. In particular, the final regulations provide guidance in determining whether a corporation is a predecessor or successor of a distributing or controlled corporation for purposes of the exception under section 355(e) of the Internal Revenue Code (Code) to the nonrecognition treatment afforded qualifying distributions. In addition, the final regulations provide certain limitations on the recognition of gain in certain cases involving a predecessor of a distributing corporation. The final regulations also provide rules regarding the extent to which section 355(f) causes a distributing corporation (and in certain cases its shareholders) to recognize income or gain on the distribution of stock or securities of a controlled corporation. These regulations affect corporations that distribute the stock or securities of a controlled corporation and the shareholders or security holders of those

distributing corporations.

DATES: Effective date: These final regulations are effective on [INSERT DATE OF FILING AT THE OFFICE OF THE *FEDERAL REGISTER*].

Applicability dates: For dates of applicability, see §1.355-8(i).

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SUPPLEMENTARY INFORMATION:

Background

I. Corporate Divisions under Sections 355 and 368(a)(1)(D)

Congress enacted section 355 “to permit the tax-free division of existing business arrangements among existing shareholders.” See S. Rep. No. 105-33, at 139 (1997) (Senate Report). Under section 355(a)(1), if certain requirements are met, a corporation (Distributing) may distribute stock, or stock and securities, of a controlled corporation (Controlled) to Distributing’s shareholders, or to its shareholders and security holders, without recognition of gain or loss to, or inclusion of any amount in income of, the distributees upon receipt (Distribution). Section 355(c) generally provides that no gain or loss is recognized to Distributing upon a Distribution of qualified property which is not in pursuance of a plan of reorganization. Section 355(c)(2)(B) refers to Controlled stock and Controlled securities as “qualified property.” If Distributing distributes property other than qualified property in a Distribution and the fair market value of such property exceeds its adjusted basis, gain is recognized to Distributing as if the property were sold to the distributee at its fair market value. See section 355(c)(2)(A).

Taxpayers also may carry out a Distribution as part of a “divisive reorganization” under section 368(a)(1)(D). A divisive reorganization is a transfer by Distributing of part of its assets to Controlled if, immediately after the transfer, one or more of the shareholders of Distributing (including persons who were shareholders immediately before the transfer) have control, as defined in section 368(c), of Controlled, but only if, in pursuance of the plan, stock or securities of Controlled are distributed in a Distribution. Section 361(c) generally provides that no gain or loss is recognized to Distributing upon a Distribution of qualified property in pursuance of a plan of reorganization. Section 361(c)(2)(B) defines “qualified property” as (i) any stock, right to acquire stock, or obligation (including a security) of Distributing, or (ii) any stock, right to acquire stock, or obligation (including a security) of Controlled received by Distributing as part of the divisive reorganization. If Distributing distributes property other than qualified property in a Distribution as part of a divisive reorganization and the fair market value of such property exceeds its adjusted basis, gain is recognized to Distributing as if the property were sold to the distributee at its fair market value. See section 361(c)(2)(A).

II. Section 355(e)

Although a Distribution is generally tax-free under sections 355 and 361, Congress has determined that recognition of corporate-level gain by Distributing is appropriate “[i]n cases in which it is intended that new shareholders will acquire ownership of a business in connection with a [Distribution],” because the overall transaction “more closely resembles a corporate level disposition of the portion of the business that is acquired.” Senate Report at 139-140. Accordingly, the enactment of

the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788 (1997)), added section 355(e) to the Code. Under section 355(e), stock or securities of Controlled generally will not be treated as qualified property for purposes of section 355(c)(2) or section 361(c)(2) if the stock or securities are distributed as part of a plan or series of related transactions (Plan) pursuant to which one or more persons acquire directly or indirectly stock representing a “50-percent or greater interest” in the stock (Planned 50-percent Acquisition) of Distributing or Controlled. The term “50-percent or greater interest,” as defined in section 355(e)(4)(A) by reference to section 355(d)(4), means stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock. Section 1.355-7(b) provides detailed guidance regarding the meaning and determination of the existence of a Plan.

Section 355(e)(4)(D) provides that, for purposes of section 355(e), “any reference to [Controlled] or [Distributing] shall include a reference to any predecessor or successor of such corporation.” However, Section 355(e) does not define the terms “predecessor” and “successor.” To provide definitions for the terms “predecessor” and “successor” for purposes of section 355(e), as well as guidance regarding their application, the Department of the Treasury (Treasury Department) and the IRS issued proposed regulations in 2004 (2004 Proposed Regulations) and temporary and proposed regulations in 2016 (2016 Regulations).

III. The 2004 Proposed Regulations and the 2016 Regulations

The general theory underlying the 2004 Proposed Regulations and the 2016 Regulations was that section 355(e) should apply if a Distribution is used to combine a

tax-free division of the assets of a corporation other than Distributing or Controlled (Divided Corporation) with a Planned 50-percent Acquisition of the Divided Corporation. The Treasury Department and the IRS view this type of transaction as a “synthetic spin-off” of the assets that are transferred by the Divided Corporation to Distributing and then to Controlled. For example, a synthetic spin-off could be achieved through the following series of transactions occurring pursuant to a Plan (Base Case Example): (1) a corporation (P) merges into Distributing in a reorganization described in section 368(a)(1)(A), (2) Distributing contributes some (but not all) of P’s assets to Controlled in a reorganization described in section 368(a)(1)(D), and (3) Distributing distributes all of the stock of Controlled in a Distribution.

In the Base Case Example, the Divided Corporation (that is, P) could have separated its assets in its own Distribution. In that case, the Divided Corporation would have been a Distributing itself, and section 355(e) clearly would have applied to the Distribution if it were combined with a Planned 50-percent Acquisition of the Divided Corporation. However, the Treasury Department and the IRS observed that if a Distribution by a Distributing is used as the vehicle for a synthetic spin-off by the Divided Corporation, the synthetic spin-off would not be subject to section 355(e) unless the Divided Corporation is treated as a predecessor of Distributing under section 355(e)(4)(D) (Predecessor of Distributing, or POD). Accordingly, the Treasury Department and the IRS issued the 2004 Proposed Regulations and the 2016 Regulations to treat the Divided Corporation in the Base Case Example as a POD.

A. 2004 Proposed Regulations

On November 22, 2004, the Treasury Department and the IRS published in the

Federal Register (69 FR 67873) the 2004 Proposed Regulations (REG-145535-02). In general, the 2004 Proposed Regulations would have defined a Predecessor of Distributing as any corporation the assets of which a Distributing has acquired in a transaction to which section 381(a) applies (Section 381 Transaction) and then divided tax-free through a Distribution. The 2004 Proposed Regulations referred to the Section 381 Transaction and the contribution to Controlled of some (but not all) of the assets of the POD prior to the Distribution as a “combining transfer” and a “separating transfer,” respectively. The Treasury Department and the IRS drafted the 2004 proposal primarily to address combining and separating transfers carried out to effect transactions similar to the Base Case Example (in other words, synthetic spin-offs effectuated through Section 381 Transactions).

B. 2016 Regulations

After considering all comments received regarding the 2004 Proposed Regulations, on December 19, 2016, the Treasury Department and the IRS published temporary regulations (TD 9805) in the **Federal Register** (81 FR 91738) (2016 Temporary Regulations), which adopted the 2004 Proposed Regulations with significant modifications. On the same day, the Treasury Department and the IRS published in the **Federal Register** (81 FR 91888) a notice of proposed rulemaking (REG-140328-15) (2016 Proposed Regulations), which cross-referenced the 2016 Temporary Regulations. A correction to the 2016 Temporary Regulations was published in the **Federal Register** (82 FR 8811) on January 31, 2017. (References to §1.355-8T in this preamble refer to the text of the 2016 Temporary Regulations as contained in 26 CFR part 1 revised as of April 1, 2019.)

Although the 2016 Regulations generally retained the synthetic spin-off theory underlying the 2004 Proposed Regulations, the Treasury Department and the IRS significantly broadened the scope of the POD definition (but also significantly narrowed its potential application, as described later in this part III.B). Commenters on the 2004 Proposed Regulations noted that a corporation could have been a POD only if the corporation transferred property to Distributing in a Section 381 Transaction (such as the merger in the Base Case Example) and questioned whether that approach was under-inclusive. In particular, one commenter explained that a taxpayer could structure a series of transactions to achieve many of the same tax and economic objectives as the Base Case Example without using a Section 381 Transaction.

To illustrate that point, the commenter described the following series of transactions, all of which occur as part of the same Plan (2016 Preamble Example). First, Distributing (the common parent of a consolidated group) acquires all of the stock of P. P then contributes some (but not all) of its assets to a wholly owned subsidiary of Distributing (Internal Distributing) in a transaction to which section 351 applies. See §1.1502-34. Thereafter, Internal Distributing (i) contributes one of the P assets to Controlled, and (ii) distributes all of the stock of Controlled to Distributing in a Distribution. Finally, Distributing distributes all of the stock of Controlled in a Distribution.

In response to these comments, the Treasury Department and the IRS broadened the POD definition in the 2016 Regulations by removing the requirement of a Section 381 Transaction from the definition. Under the 2016 Regulations, no particular transactional form was required; rather, the 2016 Regulations focused on the tax-free

division of the POD's property (however effected). The Treasury Department and the IRS revised the POD definition in this manner to ensure that section 355(e) would apply to the Base Case Example, the 2016 Preamble Example, and more generally to any synthetic spin-off that is combined with a Planned 50-percent Acquisition of the Divided Corporation. Importantly, however, the 2016 Regulations significantly limited POD treatment to transactions in which all of the steps involved in the tax-free division of property of the POD occur as part of a Plan. See section 355(e)(2)(A)(ii).

Because of these revisions to the 2004 Proposed Regulations, a variety of new transactional structures resulted in POD treatment under the 2016 Regulations. For instance, as illustrated in §1.355-8T(h), Example 5 (Example 5), a corporation was treated as a POD as a result of the following transactions, each of which occurs pursuant to the same Plan. First, P transfers some (but not all) of its assets to Distributing in exchange for 10 percent of the stock of Distributing in a transaction to which section 351 applies (leaving Distributing's other shareholder, Y, with 90 percent of Distributing's stock). Distributing then (i) contributes some (but not all) of the P assets to Controlled in a reorganization described in section 368(a)(1)(D), and (ii) distributes all of the stock of Controlled to P and Y pro rata. Finally, individual Z acquires 51 percent of the P stock. Because the assets of P were divided tax-free as part of a Plan, the 2016 Regulations treated P as a POD. As described in part II of the Summary of Comments and Explanation of Revisions, in response to comments, the Treasury Department and the IRS have further limited the scope of the POD definition in the final regulations to ensure that P will not be treated as a POD in Example 5.

In expanding the definition of a Predecessor of Distributing, the 2016 Regulations

introduced the term “Potential Predecessor.” See §1.355-8T(b)(2)(ii). Under the POD definition in the 2016 Regulations, only a Potential Predecessor could be a POD. See §1.355-8T(b)(1)(i). Thus, if a corporation were not a Potential Predecessor, it could not have been a POD under the 2016 Regulations. The 2016 Regulations defined a Potential Predecessor as any corporation other than Distributing or Controlled. See §1.355-8T(b)(2)(ii).

Summary of Comments and Explanation of Revisions

Comments were received regarding the 2016 Regulations, but no public hearing was requested or held. After consideration of these comments, this Treasury decision adopts the 2016 Proposed Regulations with limited modifications, and it removes the 2016 Temporary Regulations. In general, the final regulations follow the approach of the 2016 Regulations while incorporating certain requested clarifications and minor revisions.

I. Predecessor of Distributing Definition

The Treasury Department and the IRS are promulgating the final regulations with the same goal as the 2004 Proposed Regulations and the 2016 Regulations: to ensure that section 355(e) applies properly to synthetic spin-offs of a Divided Corporation’s assets. As noted in part II of the Background, Congress has determined that corporate-level gain should be recognized by a Distributing “[i]n cases in which it is intended that new shareholders will acquire ownership of a business in connection with a [Distribution],” because the overall transaction “more closely resembles a corporate level disposition of the portion of the business that is acquired.” Senate Report at 139-140. Consistent with this policy, the final regulations provide that a corporation cannot

qualify as a POD unless the corporation's assets are divided through a Distribution (that is, unless the corporation is a Divided Corporation).

The Treasury Department and the IRS have determined that, by limiting POD treatment to Divided Corporations, the final regulations will further the policy of section 355(e) while continuing to permit tax-free divisions of existing business arrangements among existing shareholders. See Senate Report at 139. In particular, the Treasury Department and the IRS have sought to avoid definitions that would cause section 355(e) to apply to transactions that do not resemble sales. For example, starting with the 2004 Proposed Regulations, the Treasury Department and the IRS have rejected a POD definition that would include any corporation that, without more, transfers assets to a Distributing in a Section 381 Transaction.

The following example illustrates how that rejected POD definition would have run contrary to the policies of section 355 and section 355(e). As part of a Plan, P merges tax-free into Distributing in a reorganization described in section 368(a)(1)(A), with the P shareholders receiving 40 percent of the stock of Distributing. Distributing then distributes all of the stock of Controlled (which holds none of the P assets) in a Distribution. If P were treated as a POD, the Distribution would result in gain recognition under section 355(e), because it occurred as part of the same Plan as an acquisition of a 50-percent or greater interest in P (that is, a Planned 50-percent Acquisition). See section 355(e)(3)(B). However, the Treasury Department and the IRS have determined that the policy of section 355(e) does not warrant the recognition of gain in this case, because the assets of P have not been divided and neither Distributing nor Controlled has undergone a Planned 50-percent Acquisition. Rather,

the Distribution effected a division of existing business arrangements among existing shareholders, and Congress intended section 355 to afford tax-free treatment to such a transaction. See Senate Report at 139.

II. Scope of the Potential Predecessor Definition

Commenters criticized the breadth of the POD definition in the 2016 Regulations. Although commenters generally supported the treatment of P as a POD in the 2016 Preamble Example, commenters questioned the policy of treating P as a POD in Example 5. See part III.B of the Background section (describing the 2016 Preamble Example and Example 5). After considering all comments received on this issue, and as discussed further in the remainder of this part II, the Treasury Department and the IRS have determined that the series of transactions set forth in Example 5 should not be viewed as a synthetic spin-off, and that P therefore should not be treated as a POD in Example 5.

A. Example 5 Reduces Neither the Total Value nor the Total Built-In Gain Inside P

When a corporation distributes an appreciated asset with respect to its stock, the corporation disposes of the asset for no consideration, reducing both the total value and the total built-in gain inside the corporation. In this regard, the synthetic spin-off by P in the Base Case Example resembles an actual Distribution by P of stock of a controlled corporation holding the P assets actually held by Controlled. Both transactions reduce the total value and built-in gain of P (which, in the Base Case Example, becomes part of Distributing) by the value of, and built-in gain in, the P assets held by Controlled.

By contrast, Example 5 involves a section 351 exchange by P, which reduces neither the total value nor the total built-in gain inside P. In the section 351 exchange, P

exchanges assets for Distributing stock of equal value. Under section 358, P's basis in this Distributing stock is determined by reference to P's basis in the assets exchanged therefor, and is then allocated between P's Distributing stock and the Controlled stock P receives in the Distribution. Therefore, upon the conclusion of Example 5, P holds Distributing stock and Controlled stock with an aggregate value and built-in gain equal to the aggregate value of, and built-in gain in, the assets P transferred to Distributing. Rather than disposing of an asset for no consideration (as is the case in an actual distribution of property with respect to a Distributing's stock), P merely has exchanged one asset for another in Example 5. As a result, the Treasury Department and the IRS have determined that the series of transactions set forth in Example 5 does not resemble an actual Distribution by P and should not be viewed as a synthetic spin-off.

B. Ease of Elimination of Built-In Gain in the 2016 Preamble Example

The key distinction between the 2016 Preamble Example and Example 5 is the relative ease with which a subsequent restructuring could be undertaken to eliminate P's substituted built-in gain in the 2016 Preamble Example. The 2016 Preamble Example, like Example 5, involves a section 351 exchange in which P exchanges assets for Internal Distributing stock with the same value and built-in gain. Unlike in Example 5, however, Distributing in the 2016 Preamble Example directly and indirectly owns 100 percent of the stock of both P and Internal Distributing. As a result, in the 2016 Preamble Example, Distributing could unilaterally eliminate the built-in gain preserved in P's Internal Distributing stock through an internal restructuring. The occurrence of such an internal restructuring would make the 2016 Preamble Example difficult to distinguish from the Base Case Example.

By contrast, upon the conclusion of Example 5, P owns only 10 percent of the stock of each of Distributing and Controlled, whereas corporation Y owns 90 percent. Although it may be theoretically possible for P to eliminate its built-in gain in this stock through certain transactions involving Distributing and Controlled, P lacks any meaningful control over either corporation. In addition, the Treasury Department and the IRS note that such built-in gain elimination transactions generally would carry significant non-tax consequences. Therefore, it would be unreasonable to assume that such transactions would occur and that P's built-in gain in the Distributing and Controlled stock would be eliminated after the Distribution.

One commenter asserted that there is little opportunity for P to engage in a subsequent restructuring to eliminate its built-in gain in Distributing or Controlled stock in a case like Example 5 or the 2016 Preamble Example unless P is a member of Distributing's affiliated group (as defined in section 1504 without regard to section 1504(b)) (Expanded Affiliated Group). The Treasury Department and the IRS agree with this comment.

Based on the foregoing, the final regulations define the term Potential Predecessor as any corporation other than Distributing or Controlled, but only if either (i) as part of a Plan, the corporation transfers property to a Potential Predecessor, Distributing, or a member of the same Expanded Affiliated Group as Distributing in a Section 381 Transaction (as in the Base Case Example), or (ii) immediately after completion of the Plan, the corporation is a member of the same Expanded Affiliated Group as Distributing (as in the 2016 Preamble Example). Accordingly, under the final regulations, P in Example 5 is not a Potential Predecessor (and thus cannot be a POD).

III. Pre-Distribution and Post-Distribution Requirements

A. Overview

Under the 2016 Regulations, a Potential Predecessor qualified as a POD only if two pre-Distribution requirements and one post-Distribution requirement were satisfied. The Treasury Department and the IRS intended that these requirements, taken together, (i) composed a technical description of a synthetic spin-off, and (ii) limited POD treatment to Potential Predecessors the assets of which are divided tax-free through a Distribution by Distributing. The following discussion summarizes these requirements.

1. First pre-Distribution requirement: Relevant Property

To satisfy the first pre-Distribution requirement, any Controlled stock distributed in the Distribution must have been (i) Relevant Property, the gain on which was not recognized in full as part of a Plan, or (ii) acquired by Distributing for Relevant Property, the gain on which was not recognized in full as part of a Plan, and that was held by Controlled immediately before the Distribution (Relevant Property Requirement). The term “Relevant Property” generally referred to any property held by the Potential Predecessor at any point during the Plan Period (that is, the period that ends immediately after the Distribution and begins on the earliest date on which any part of the Plan is agreed to or understood, arranged, or substantially negotiated). See §1.355-8T(b)(2)(iv).

2. Second pre-Distribution requirement: Controlled stock reflects basis of Separated Property

To satisfy the second pre-Distribution requirement, any Controlled stock distributed in the Distribution must have reflected the basis of any Separated Property

(Reflection of Basis Requirement). In general, the 2016 Regulations defined the term “Separated Property” as any Relevant Property relied on to satisfy the Relevant Property Requirement. See §1.355-8T(b)(2)(vii). The 2016 Regulations did not define the phrase reflect the basis.

3. Post-Distribution Requirement: Division of Relevant Property

To satisfy the post-Distribution requirement, immediately following the Distribution, ownership of Relevant Property must have been divided between Controlled, on the one hand, and Distributing or the Potential Predecessor, on the other hand (Division of Relevant Property Requirement).

B. Relevant Property Requirement: Fluctuations in Value

One commenter requested clarification of the Relevant Property Requirement’s application to a case in which (i) gain on Relevant Property is fully recognized at some point during the Plan Period, but (ii) the Relevant Property subsequently appreciates so that built-in gain exists at the time of the Distribution. The Treasury Department and the IRS did not intend for fluctuations in value to affect the determination of POD status under the 2016 Regulations. Consequently, the final regulations replace the requirement that gain on Relevant Property not be recognized in full “as part of a Plan” with the requirement that gain (if any) on Relevant Property not be recognized in full “at any point during the Plan Period.”

C. Reflection of Basis Requirement

The Treasury Department and the IRS have received numerous comments requesting clarification of the Reflection of Basis Requirement’s scope and purpose. These comments arose from the failure of the 2016 Regulations to define the phrase

reflect the basis.

To highlight the potential overbreadth of this undefined phrase, one commenter questioned whether P could qualify as a POD solely through a basis adjustment under §1.1502-32. In the commenter's example, P and unrelated Distributing (which is the common parent of a consolidated group) form corporation X in a section 351 exchange in which P contributes Asset 1 and Distributing contributes other assets in exchange for X stock, with Distributing receiving at least 80 percent of X's stock by vote and value. Thereafter, Distributing contributes its X stock to Controlled in exchange for Controlled stock. Then, because of items relating to Asset 1, Distributing's basis in its Controlled stock is adjusted under §1.1502-32. Finally, Distributing distributes all of the stock of Controlled. Based on this illustrative example, the commenter expressed concern that the §1.1502-32 basis adjustment could cause Distributing's Controlled stock to reflect the basis of Asset 1, and the commenter asserted that treating P as a POD in this case would be inappropriate.

The Treasury Department and the IRS did not intend the Reflection of Basis Requirement in the 2016 Regulations to be satisfied solely by a basis adjustment under §1.1502-32. The Reflection of Basis Requirement served two related purposes. First, the Treasury Department and the IRS intended the Reflection of Basis Requirement to ensure a connection between the gain in the POD's property held by Controlled and the gain that Distributing must recognize under section 355(e). Second, the Treasury Department and the IRS intended this requirement to avoid improper duplication of gain if Controlled stock is distributed in multiple Distributions as part of the same Plan. See §1.355-8T(h), Example 7 (concluding with respect to consecutive Distributions that,

although P is a POD with respect to the first Distribution, P is not a POD with respect to the second Distribution because the C stock distributed in the second Distribution did not reflect the basis of any Separated Property).

The Treasury Department and the IRS have addressed these concerns in the final regulations by clearly articulating the Reflection of Basis Requirement. The final regulations clarify that the Reflection of Basis Requirement is satisfied only if any Controlled stock that satisfies the Relevant Property Requirement had a basis prior to the Distribution that was determined, in whole or in part, by reference to the basis of Separated Property. The final regulations make the same clarification to the two other provisions that, under the 2016 Regulations, referred to a reflection of basis: §1.355-8T(b)(2)(vi)(B)(2) (regarding the treatment of Controlled stock as a Substitute Asset); and §1.355-8T(b)(2)(x) (providing a deemed exchange rule for purposes of the Relevant Property Requirement, the Reflection of Basis Requirement, and the Substitute Asset definition).

In addition, the final regulations clarify that the Reflection of Basis Requirement is satisfied only if, during the Plan Period prior to the Distribution, any Controlled stock that satisfies the Relevant Property Requirement (and the first prong of the Reflection of Basis Requirement) was neither distributed in a section 355(e) distribution nor transferred in a transaction in which the gain (if any) on that Controlled stock was recognized in full. This clarification ensures that the final regulations cannot be interpreted in a manner that would give rise to improper duplication of gain, a policy objective of the Treasury Department and the IRS in issuing the 2016 Regulations.

D. Treatment of Property Acquired Not Pursuant to a Plan

One commenter requested that the Treasury Department and the IRS clarify that property acquired by a Potential Predecessor during the Plan Period would not be treated as Relevant Property if not acquired pursuant to a Plan. In particular, the commenter presented an example in which a Potential Predecessor becomes a member of Distributing's consolidated group pursuant to a Plan. Prior to a Distribution, the Potential Predecessor acquires from other members of Distributing's consolidated group property that had not been transferred directly or indirectly to Distributing pursuant to the Plan. The commenter requested clarification that this property is not Relevant Property.

The commenter's specific concern was already addressed by an exception to the Relevant Property definition in the 2016 Regulations (see §1.355-8T(b)(2)(iv)(B)), and the final regulations retain this exception. This exception provides that property held directly or indirectly by Distributing is Relevant Property of a Potential Predecessor only to the extent that the property (1) was transferred directly or indirectly to Distributing during the Plan Period, and (2) was Relevant Property of the Potential Predecessor before the direct or indirect transfers. This exception exempts the property in the commenter's example from treatment as Relevant Property because the property was not transferred directly or indirectly to Distributing during the Plan Period.

In addition, the final regulations include a Plan limitation in the Division of Relevant Property Requirement. Thus, the Division of Relevant Property Requirement will be satisfied only if ownership of a Potential Predecessor's Relevant Property has been divided as part of a Plan. Both the preamble to the 2016 Regulations and the text of §1.355-8T(a)(3) (summarizing the POD definition) described the Division of Relevant

Property Requirement in the 2016 Regulations as including a Plan limitation, and the Treasury Department and the IRS had intended for §1.355-8T(b)(1)(iii) (the Division of Relevant Property Requirement) to include this limitation. The Treasury Department and the IRS intend that the Plan limitation in the Division of Relevant Property Requirement will ensure more generally that Relevant Property acquired by a Potential Predecessor during the Plan Period, but not pursuant to a Plan, will not result in an inappropriate application of section 355(e).

E. Stock of Distributing as Relevant Property

One commenter questioned whether a reference in §1.355-8T(b)(2)(v) (limiting the circumstances under which Distributing stock is treated as Relevant Property) to §1.355-8T(b)(1)(ii) (the Relevant Property Requirement and the Reflection of Basis Requirement) was intended to refer instead to §1.355-8T(b)(1)(iii) (the Division of Relevant Property Requirement). The Treasury Department and the IRS intended for §1.355-8T(b)(2)(v) to reference the Division of Relevant Property Requirement and have incorporated this revision into the final regulations.

IV. Implicit Permission

Although §1.355-7 generally governs the determination of whether a Distribution and an acquisition of a 50-percent or greater interest in a POD have occurred as part of the same Plan, the 2016 Regulations contained special rules in this regard. See §1.355-8T(a)(4)(ii). In general, references to Distributing in §1.355-7 included references to a POD. However, any agreement, understanding, arrangement, or substantial negotiations regarding the acquisition of the stock of a POD were analyzed under §1.355-7 with respect to the actions of officers or directors of Distributing or

Controlled, controlling shareholders of Distributing or Controlled, or a person acting with permission of one of those persons. For that purpose, references in §1.355-7 to Distributing did not include references to a POD. Therefore, the actions of officers, directors, or controlling shareholders of a POD, or of a person acting with the implicit or explicit permission of one of those persons, would not have been considered for this purpose unless those persons otherwise would have been treated as acting on behalf of Distributing or Controlled under §1.355-7. The final regulations retain these rules.

One commenter expressed concern regarding the potential scope of the “implicit permission” concept in §1.355-7 given that the 2016 Regulations contemplated that actions on behalf of a Potential Predecessor may be taken into account if such actions were carried out with the implicit permission of Distributing. The Treasury Department and the IRS have not addressed this comment in the final regulations because the implicit permission concept is a component of §1.355-7 and therefore is beyond the scope of this Treasury decision.

V. Successors

Under section 355(e)(4)(D), any reference to Controlled or Distributing includes a reference to any successor of such corporation (Successor). Like the 2004 Proposed Regulations, the 2016 Regulations limited the definition of the term Successor to a corporation to which Distributing or Controlled (as the case may be) transfers property in a Section 381 Transaction after the Distribution. A partnership cannot receive assets in a Section 381 Transaction. Accordingly, a partnership could not have been a Successor under either the 2004 Proposed Regulations or the 2016 Regulations. As noted later in this part V, the final regulations retain this approach.

The 2004 Proposed Regulations and the 2016 Regulations also contained a deemed acquisition rule (see §1.355-8T(d)(2)). Under this rule, after a Section 381 Transaction, an acquisition of stock of the acquiring corporation is treated also as an acquisition of the stock of the distributor or transferor corporation in the Section 381 Transaction. Thus, if the assets of Distributing or any POD are acquired by another corporation in a Section 381 Transaction, then any subsequent acquisition of the stock of the acquiring corporation is treated also as an acquisition of the stock of Distributing or the POD, as the case may be.

As a result of these rules, a corporation's status as a Successor of Distributing or Controlled matters only insofar as an acquisition of its stock is treated as an acquisition of the stock of Distributing or Controlled, respectively, which could result in a Planned 50-percent Acquisition of Distributing or Controlled. Therefore, the only significance of a Planned 50-percent Acquisition of a Successor is its treatment as a deemed Planned 50-percent Acquisition of Distributing or Controlled (as the case may be). Accordingly, if any of the stock of Distributing or Controlled has been acquired in, or prior to, a Section 381 Transaction, the application of section 355(e) will turn on whether a Planned 50-percent Acquisition of Distributing or Controlled has occurred, taking into account acquisitions of the stock of Distributing or Controlled in, and prior to, the Section 381 Transaction, as well as any acquisitions of the stock of the Successor following the Section 381 Transaction.

Commenters supported this approach, and the Treasury Department and the IRS have retained it in the final regulations. Thus, under the final regulations, a Successor of Distributing or of Controlled must be a corporation to which Distributing or Controlled,

respectively, transfers property in a Section 381 Transaction after the Distribution. A partnership cannot be a Successor of Distributing or Controlled under the final regulations for purposes of section 355(e). Certain references in the 2016 Regulations to a Planned 50-percent Acquisition of a Successor have been refined to clarify the significance of Successor status.

VI. Gain Limitation Rules

Taken together, sections 355(e), 355(c), and 361(c) generally require Distributing to recognize any gain in Controlled stock and securities distributed in a Distribution that is part of the same Plan as a Planned 50-percent Acquisition of a POD, Distributing, or Controlled (the amount of such gain, Statutory Recognition Amount). However, the 2016 Regulations contained special rules that limited the amount of gain that section 355(e) causes Distributing to recognize in certain cases involving a POD. In cases involving a Planned 50-percent Acquisition of a POD, §1.355-8T(e)(2) (POD Gain Limitation Rule) generally limited the amount of gain Distributing was required to recognize to any built-in gain in the POD's Separated Property (generally, POD assets held by Controlled). Similarly, in cases involving a Planned 50-percent Acquisition of Distributing as the result of a transfer by a POD to Distributing in a Section 381 Transaction, §1.355-8T(e)(3) (Distributing Gain Limitation Rule) generally reduced the amount of gain Distributing was required to recognize by the built-in gain in the POD's Separated Property. In addition, in cases involving multiple Planned 50-percent Acquisitions, §1.355-8T(e)(1) generally provided that the total gain limitation applicable under §1.355-8T(e) is determined by adding the Statutory Recognition Amount (subject to the POD Gain Limitation Rule and the Distributing Gain Limitation Rule) with respect

to each Planned 50-percent Acquisition. Finally, §1.355-8T(e)(4) provided that the amount required to be recognized by Distributing under section 355(e) with regard to a single Distribution will not exceed the Statutory Recognition Amount.

Commenters questioned why the 2016 Regulations limited the Distributing Gain Limitation Rule to Section 381 Transactions, and recommended expanding the Distributing Gain Limitation Rule so that it applies to any Planned 50-Percent Acquisition of Distributing. In particular, one commenter asserted that the form of the transaction in which a Planned 50-percent Acquisition of Distributing occurs should not be relevant to the application of the gain limitation rules.

As discussed in the preamble to the 2016 Regulations, the Treasury Department and the IRS intended the Distributing Gain Limitation Rule to minimize the Federal income tax impact of directionality between economically equivalent Section 381 Transactions. In other words, the Distributing Gain Limitation Rule was intended to ensure that the amount of gain required to be recognized under section 355(e) would be the same regardless of whether the smaller or the larger corporation in a Section 381 Transaction acts as the acquiring corporation. The Distributing Gain Limitation Rule was limited to Section 381 Transactions in the 2016 Regulations because the direction of other types of transactions (such as section 351 exchanges) generally cannot be reversed without changing the substance of the transaction, and thus generally do not implicate the policy of directional neutrality. However, upon further study, the Treasury Department and the IRS have determined that the policy underlying the Distributing Gain Limitation Rule should not be limited to directional neutrality.

The POD definition is based on the theory that a Distribution that effects a tax-

free division of the assets of a corporation other than Distributing (a POD) may be viewed as two separate Distributions: one by the POD (of a Controlled holding the Separated Property) (POD Distribution), and one by Distributing (of a Controlled holding all of the property held by Controlled in the actual Distribution other than the Separated Property) (Non-POD Distribution). Section 355(e) requires gain recognition when new shareholders acquire ownership of a business in connection with a spin-off. Thus, when a Planned 50-percent Acquisition of a POD occurs in connection with a POD Distribution, the final regulations require gain recognition under section 355(e). However, unless there is also a Planned 50-percent Acquisition of Distributing, the Non-POD Distribution represents a division of existing business arrangements among existing shareholders, to which Congress intended to afford tax-free treatment. See Senate Report at 139-140. Accordingly, the POD Gain Limitation Rule limits the amount of gain required to be recognized to the built-in gain on the Separated Property.

The same policy goals justify the expansion of the Distributing Gain Limitation Rule so that it applies to any Planned 50-percent Acquisition of Distributing—however and by whomever effected. If a Distribution involves a POD and occurs in connection with a Planned 50-percent Acquisition of Distributing (but no Planned 50-percent Acquisition of the POD or Controlled), then the POD Distribution should not be subject to gain recognition because it represents a division of existing business arrangements among existing shareholders.

Accordingly, the Distributing Gain Limitation Rule in the final regulations applies if there is a Planned 50-percent Acquisition of Distributing. However, consistent with the policy underlying the Distributing Gain Limitation Rule, a Distribution will benefit from the

Distributing Gain Limitation Rule only if a POD exists and does not also undergo a Planned 50-percent Acquisition. If no POD exists, then the limitation under the Distributing Gain Limitation Rule will equal the Statutory Recognition Amount, because there is no Separated Property. If a POD exists but also undergoes a Planned 50-percent Acquisition, then Distributing must recognize the Statutory Recognition Amount with respect to the Planned 50-percent Acquisition of the POD (subject to the POD Gain Limitation Rule) and the Planned 50-percent Acquisition of Distributing (subject to the Distributing Gain Limitation Rule). See §1.355-8(e)(1)(ii) of the final regulations (Multiple Planned 50-percent Acquisitions). Similarly, if there are Planned 50-percent Acquisitions of both Distributing and Controlled, Distributing must recognize the Statutory Recognition Amount with respect to the Planned 50-percent Acquisition of Controlled (which is not eligible for limitation under any gain limitation rule) and the Planned 50-percent Acquisition of Distributing (subject to the Distributing Gain Limitation Rule). Although the multiple Planned 50-percent Acquisition rule just described may deny any benefit under the gain limitation rules, in no event will the final regulations require Distributing to recognize an amount that exceeds the Statutory Recognition Amount with regard to a single Distribution. See §1.355-8(e)(4) of the final regulations (gain recognition limited to Statutory Recognition Amount).

The Treasury Department and the IRS have clarified the gain limitation rules in the final regulations to make them easier to understand and apply. The Treasury Department and the IRS also have refined the calculation of the gain limitation under the Distributing Gain Limitation Rule to account for the possibility of more than one POD with respect to a single Distribution. In addition, to clarify that both built-in gain and

built-in loss assets are taken into account in computing any applicable gain limitation, the Treasury Department and the IRS have refined the description of gain in the Relevant Property Requirement by adding the parenthetical phrase “(if any),” and have added a similar clarification to the Separated Property definition.

VII. Relevant Equity

The 2016 Temporary Regulations used the defined term “Relevant Stock” (stock that is Relevant Property) in connection with the defined terms “Separated Property” and “Underlying Property” (property directly or indirectly held by a corporation that is the issuer of Relevant Stock). See §1.355-8T(b)(2)(iv), (vii), and (viii). These terms were used to ensure that gain would not be duplicated in determining the applicable gain limitation amount (if any) if the Relevant Property held by Controlled included stock in a corporation. The potential for duplication existed because the gain limitation is calculated based on the built-in gain in Relevant Property held by Controlled, and the definition of “Relevant Property” included assets held directly or indirectly (and thus included both stock of a corporation and any assets held by the corporation).

The Treasury Department and the IRS have determined that a similar risk of duplicated gain exists when Relevant Property includes an interest in a partnership. Accordingly, the final regulations replace the term “Relevant Stock” with the term “Relevant Equity,” which means Relevant Property that is an equity interest in a corporation or a partnership. This clarification relates only to the determination of the limitation on gain under §1.355-8(e) of the final regulations (if any).

VIII. Section 336(e)

The 2016 Regulations prohibited a section 336(e) election if the amount of gain

required to be recognized by Distributing with respect to the Distribution was less than the Statutory Recognition Amount due to the POD Gain Limitation Rule or the Distributing Gain Limitation Rule. This prohibition applied even if Distributing chose to recognize the Statutory Recognition Amount under §1.355-8T(e)(4). One commenter criticized this prohibition as “inequitable as a policy matter and unnecessary as an administrative one.”

Although the final regulations retain this prohibition, the Treasury Department and the IRS continue to study and request comments on the following issues: (1) whether permitting a section 336(e) election in this context would be consistent with the policy of section 336(e), (2) whether permitting a section 336(e) election in this context could give rise to inappropriate planning opportunities, (3) whether permitting a section 336(e) election in this context only if the Separated Property accounts for a certain minimum percentage of Controlled’s value or built-in gain would be appropriate, and (4) whether limiting the deemed asset disposition that results from a section 336(e) election in this context to a deemed disposition of the Separated Property would be appropriate.

IX. Stock Deemed Acquired in a Section 381 Transaction

Section 355(e)(3)(B) provides a special rule for certain asset acquisitions. For purposes of section 355(e), if the assets of Distributing or Controlled are acquired by a successor corporation in a transaction described in section 368(a)(1)(A), (C), or (D), or in any other transaction specified in regulations, the shareholders (immediately before the acquisition) of the successor corporation are treated as acquiring stock in Distributing or Controlled, respectively, except as otherwise provided in regulations. Similarly, the 2016 Regulations provided that any Section 381 Transaction is treated as

an acquisition of stock in the distributor or transferor corporation by shareholders of the acquiring corporation. A commenter pointed out a mathematical error in the textual example that followed this rule (in §1.355-8T(d)(1)). The final regulations correct this error and make minor clarifications to improve the readability of the operative rule.

X. No Step Transaction Implications from Examples

One commenter suggested that the Treasury Department and the IRS clarify that no inference should be drawn from the examples in §1.355-8T(h) as to the intended application of the step transaction doctrine and other general Federal income tax principles. The Treasury Department and the IRS did not intend for any such inference to be drawn, and have added a specific disclaimer to this effect in the final regulations.

XI. Transition Rule

The 2016 Regulations generally applied to Distributions occurring after January 18, 2017. However, under a transition rule, the 2016 Regulations generally did not apply to a Distribution that was (A) made pursuant to a binding agreement in effect on or before December 16, 2016 and at all times thereafter; (B) described in a ruling request submitted to the IRS on or before December 16, 2016; or (C) described on or before December 16, 2016 in a public announcement or in a filing with the Securities and Exchange Commission. For the transition rule to apply, the agreement, ruling request, public announcement, or filing described in the preceding sentence had to describe all steps relevant to the determination of POD status. See §1.355-8T(i)(2)(ii).

One commenter criticized the “all relevant steps” rule in §1.355-8T(i)(2)(ii) as “extremely narrow” and inappropriate for immediately effective regulations. This commenter contended that it is “unlikely that all such transactions would be described . .

. until very late in the long and expensive process of a corporate separation, if at all.”

The Treasury Department and the IRS note that the 2016 Regulations were not immediately applicable; they were published on December 19, 2016, but they generally applied only to Distributions that occurred after January 18, 2017. Moreover, the final regulations do not contain a transition rule, so the commenter’s concern is relevant only to transactions that were the subject of an agreement, ruling request, public announcement, or public filing that occurred in 2016 (or before). Finally, despite the commenter’s general concern, the Treasury Department and the IRS are unaware of any transactions that failed to qualify for the transition rule due to the “all relevant steps” rule in §1.355-8T(i)(2)(ii). Accordingly, the Treasury Department and the IRS have determined that it is not necessary to reconsider the transition rule in the 2016 Regulations as part of this Treasury decision.

XII. Additional Clarifications

Commenters noted generally that certain aspects of the 2016 Regulations were complicated and difficult to understand. The Treasury Department and the IRS have refined and clarified certain aspects of the 2016 Regulations in the final regulations to make the rules easier to follow and understand. For instance, certain paragraphs in the 2016 Regulations that were long and contained multiple distinct rules have been subdivided in the final regulations. In addition, defined terms have been added for certain rules (such as the Relevant Property Requirement, the Reflection of Basis Requirement, and the Division of Relevant Property Requirement). These defined terms are intended to allow the reader to more intuitively grasp the meaning of the numerous provisions cross-referenced in the final regulations.

Section 1.355-8T(c)(1) defined the term “Predecessor of Controlled” and provided certain rules relating to Predecessors of Controlled. One of these rules provided that, for purposes of §1.355-8T(c)(1), a reference to Controlled included a reference to a Predecessor of Controlled. However, another provision in the 2016 Regulations (§1.355-8T(a)(4)(i)) provided more generally that, except as otherwise provided, any reference to Controlled included, as the context may have required, a reference to any Predecessor of Controlled. Accordingly, the rule in §1.355-8T(c)(1) was unnecessary, and the Treasury Department and the IRS have omitted it in the final regulations.

XIII. Examples

The Treasury Department and the IRS have modified three of the examples contained in the 2016 Regulations (Examples 5, 7, and 8), and omitted one example (Example 6), for the reasons described in this part XIII. All of the retained examples have been updated to reflect modifications in the final regulations. For instance, the POD analyses in Examples 3 and 4 eliminate the statement that Controlled stock is Separated Property, because that fact is no longer relevant under the revised Reflection of Basis Requirement. In some of the examples, the analysis has been clarified to make it easier to follow and understand.

The facts of Example 5 of the 2016 Regulations have been retained, but the consequences of the example have changed due to the modification the Treasury Department and the IRS have made to the Potential Predecessor definition. As a result of this modification, P in Example 5 is no longer a Potential Predecessor (and thus is not a POD for that reason).

Example 6 of the 2016 Regulations has been omitted. This example illustrated a variation on Example 5 that used a forward triangular merger instead of a section 351 exchange. However, due to the modification to the Potential Predecessor definition, P in Example 6 is no longer a Potential Predecessor (and thus is not a POD for that reason), which eliminates the utility of this example.

Example 7 of the 2016 Regulations has been incorporated into new Example 6 in the final regulations, which is based on the 2016 Preamble Example.

Example 8 of the 2016 Regulations has been retained as Example 7 in the final regulations, but has been modified so that P1 and P2 are Potential Predecessors under the final regulations. In particular, the section 351 exchange between P2 and D has been replaced by a Section 381 Transaction in which P2 merges into D.

Applicability Date

Section 7805(b)(1)(A) and (B) of the Code generally provide that no temporary, proposed, or final regulation relating to the internal revenue laws may apply to any taxable period ending before the earliest of (A) the date on which such regulation is filed with the **Federal Register**, or (B) in the case of a final regulation, the date on which a proposed or temporary regulation to which the final regulation relates was filed with the **Federal Register**. In addition, section 7805(e) provides that any temporary regulation shall also be issued as a proposed regulation, and that such temporary regulation shall expire within 3 years after the date of issuance of the temporary regulation.

The final regulations, the substance of which is generally the same as that of the 2016 Regulations, apply to Distributions that occur after December 15, 2019, the day before the expiration date of the 2016 Temporary Regulations.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations would primarily affect large corporations with a substantial number of shareholders, as well as corporations that are members of large corporate groups. Additionally, the Treasury Department and the IRS have determined that no additional burden will be associated with these final regulations. Therefore, a regulatory flexibility analysis is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, the 2016 Proposed Regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses, and no comments were received.

Drafting Information

The principal author of these regulations is W. Reid Thompson of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.355-8T and adding an entry in numerical order for §1.355-8 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.355-8 also issued under 26 U.S.C. 336(e), 355(e)(3)(B), 355(e)(5), and 355(f).

* * * * *

Par. 2. Section 1.355-0 is amended by revising the introductory text, removing the entries for §1.355-8T, and adding the entries for §1.355-8 to read as follows:

§1.355-0 Outline of sections.

In order to facilitate the use of §§1.355-1 through 1.355-8, this section lists the major paragraphs in those sections as follows:

* * * * *

§1.355-8 Definition of predecessor and successor and limitations on gain recognition under section 355(e) and section 355(f).

- (a) In general.
 - (1) Scope.
 - (2) Overview.
 - (i) Purposes and conceptual overview.
 - (ii) References to and definitions of terms used in this section.
 - (iii) Special rules and examples.
 - (3) Purposes of section; Predecessor of Distributing overview.
 - (i) Purposes.
 - (ii) Predecessor of Distributing overview.
 - (A) Relevant Property transferred to Controlled.
 - (B) Relevant Property includes Controlled Stock.

- (4) References.
 - (i) References to Distributing or Controlled.
 - (ii) References to Plan or Distribution.
 - (iii) Plan Period.
- (5) List of definitions.
 - (b) Predecessor of Distributing.
 - (1) Definition.
 - (i) In general.
 - (ii) Pre-Distribution requirements.
 - (A) Relevant Property requirement.
 - (B) Reflection of basis requirement.
 - (iii) Post-Distribution requirement.
 - (2) Additional definitions and rules related to paragraph (b)(1) of this section.
 - (i) References to Distributing and Controlled.
 - (ii) Potential Predecessor.
 - (A) Potential Predecessor definition.
 - (B) Expanded Affiliated Group definition.
 - (iii) Successors of Potential Predecessors.
 - (iv) Relevant Property; Relevant Equity.
 - (A) In general.
 - (B) Property held by Distributing.
 - (C) F reorganizations.
 - (v) Stock of Distributing as Relevant Property.
 - (A) In general.
 - (B) Certain reorganizations.
 - (vi) Substitute Asset.
 - (A) In general.
 - (B) Controlled stock received by Distributing.
 - (1) In general.
 - (2) Exception.
 - (C) Treatment as Relevant Property.
 - (vii) Separated Property.
 - (viii) Underlying Property.
 - (ix) Multiple Predecessors of Distributing.
 - (x) Deemed exchanges.
 - (c) Additional definitions.
 - (1) Predecessor of Controlled.
 - (2) Successors.
 - (i) In general.
 - (ii) Determination of Successor status.
 - (3) Section 381 Transaction.
 - (d) Special acquisition rules.
 - (1) Deemed acquisitions of stock in Section 381 Transactions.
 - (i) Rule.
 - (ii) Example.
 - (2) Deemed acquisitions of stock after Section 381 Transactions.

- (3) Separate counting for Distributing and each Predecessor of Distributing.
- (e) Special rules for limiting gain recognition.
 - (1) Overview.
 - (i) Gain limitation.
 - (ii) Multiple Planned 50-percent Acquisitions.
 - (iii) Statutory Recognition Amount limit; Section 336(e).
 - (2) Planned 50-percent Acquisition of a Predecessor of Distributing.
 - (i) In general.
 - (ii) Operating rules.
 - (A) Separated Property other than Controlled stock.
 - (B) Controlled stock that is Separated Property.
 - (C) Anti-duplication rule.
 - (3) Planned 50-percent Acquisition of Distributing.
 - (4) Gain recognition limited to Statutory Recognition Amount.
 - (5) Section 336(e) election.
- (f) Predecessor or Successor as a member of the affiliated group.
- (g) Inapplicability of section 355(f) to certain intra-group Distributions.
 - (1) In general.
 - (2) Alternative application of section 355(f).
 - (h) Examples.
 - (i) Applicability date.

§1.355-8T [Removed]

Par. 3. Section 1.355-8T is removed.

Par. 4. Section 1.355-8 is added to read as follows:

§1.355-8 Definition of predecessor and successor and limitations on gain recognition under section 355(e) and section 355(f).

(a) In general--(1) Scope. For purposes of section 355(e), this section provides rules under section 355(e)(4)(D) to determine whether a corporation is treated as a predecessor or successor of a distributing corporation (Distributing) or a controlled corporation (Controlled) with respect to a distribution by Distributing of stock (or stock and securities) of Controlled that qualifies under section 355(a) (or so much of section 356 as relates to section 355) (Distribution). This section also provides rules limiting the amount of Distributing's gain recognized under section 355(e) on a Distribution if section 355(e) applies to an acquisition by one or more persons, as part of a Plan, of stock that

in the aggregate represents a 50-percent or greater interest (Planned 50-percent Acquisition) of a Predecessor of Distributing, or a Planned 50-percent Acquisition of Distributing. In addition, this section provides rules regarding the application of section 336(e) to a Distribution to which this section applies. This section also provides rules regarding the application of section 355(f) to a Distribution in certain cases.

(2) Overview--(i) Purposes and conceptual overview. Paragraph (a)(3) of this section summarizes the two principal purposes of this section and sets forth a brief conceptual overview of the scenarios in which a corporation may be a Predecessor of Distributing.

(ii) References to and definitions of terms used in this section. Paragraph (a)(4) of this section provides rules regarding references to the terms Distributing, Controlled, Distribution, Plan, and Plan Period for purposes of section 355(e), §1.355-7, and this section. Paragraph (a)(5) of this section lists the terms used in this section and indicates where each term is defined. Paragraph (b) of this section defines the term Predecessor of Distributing and several related terms. Paragraph (c) of this section defines the terms Predecessor of Controlled, Successor (of Distributing or Controlled), and Section 381 Transaction.

(iii) Special rules and examples. Paragraph (d) of this section provides guidance with regard to acquisitions and deemed acquisitions of stock if there is a Predecessor of Distributing or a Successor of either Distributing or Controlled. Paragraph (e) of this section provides two rules that may limit the amount of Distributing's gain on a Distribution if there is a Predecessor of Distributing, as well as an overall gain limitation. Paragraph (e) of this section also provides guidance with respect to the application of

section 336(e). Regardless of whether there is a Predecessor of Distributing, Predecessor of Controlled, or Successor of either Distributing or Controlled, paragraph (f) of this section provides a special rule relating to section 355(e)(2)(C), which provides that section 355(e) does not apply to certain transactions within an Expanded Affiliated Group. Paragraph (g) of this section provides rules coordinating the application of section 355(f) with the rules of this section. Paragraph (h) of this section contains examples that illustrate the rules of this section.

(3) Purposes of section; Predecessor of Distributing overview--(i) Purposes. The rules in this section have two principal purposes. The first is to ensure that section 355(e) applies to a Distribution if, as part of a Plan, some of the assets of a Predecessor of Distributing are transferred directly or indirectly to Controlled without full recognition of gain, and the Distribution accomplishes a division of the assets of the Predecessor of Distributing. The second is to ensure that section 355(e) applies when there is a Planned 50-percent Acquisition of a Successor of Distributing or Successor of Controlled. The rules of this section must be interpreted and applied in a manner that is consistent with and reasonably carries out the purposes of this section.

(ii) Predecessor of Distributing overview. The term Predecessor of Distributing is defined in paragraph (b) of this section. Only a Potential Predecessor can be a Predecessor of Distributing. See paragraph (b)(1)(i) of this section. A Potential Predecessor can be a Predecessor of Distributing only if, as part of a Plan, the Distribution accomplishes a division of the assets of the Potential Predecessor. See paragraph (b)(1)(iii) of this section. Accordingly, in the absence of that Plan, a Predecessor of Distributing cannot exist for purposes of section 355(e). The detailed

rules set forth in paragraph (b) of this section provide that a Potential Predecessor the assets of which are divided as part of a Plan may be a Predecessor of Distributing in either of the following two scenarios:

(A) Relevant Property transferred to Controlled. As part of the Plan, one or more of the Potential Predecessor's assets were transferred to Controlled in one or more tax-deferred transactions prior to the Distribution.

(B) Relevant Property includes Controlled Stock. The Potential Predecessor's assets included Controlled stock that, as part of the Plan, was transferred to Distributing in one or more tax-deferred transactions prior to the Distribution.

(4) References--(i) References to Distributing or Controlled. For purposes of section 355(e), except as otherwise provided in this section, any reference to Distributing or Controlled includes, as the context may require, a reference to any Predecessor of Distributing or any Predecessor of Controlled, respectively, or any Successor of Distributing or Controlled, respectively. However, except as otherwise provided in this section, a reference to a Predecessor of Distributing or to a Successor of Distributing does not include a reference to Distributing, and a reference to a Predecessor of Controlled or to a Successor of Controlled does not include a reference to Controlled.

(ii) References to Plan or Distribution. Except as otherwise provided in this section, references to a Plan in this section are references to a plan within the meaning of §1.355-7. References to a distribution in §1.355-7 include a reference to a Distribution and other related pre-Distribution transactions that together effect a division of the assets of a Predecessor of Distributing. In determining whether a Distribution and

a Planned 50-percent Acquisition of a Predecessor of Distributing, Distributing (including any Successor thereof), or Controlled (including any Successor thereof) are part of a Plan, the rules of §1.355-7 apply. In applying those rules, references to Distributing or Controlled in §1.355-7 generally include references to any Predecessor of Distributing and any Successor of Distributing, or any Successor of Controlled, as appropriate. However, with regard to any possible Planned 50-percent Acquisition of a Predecessor of Distributing, any agreement, understanding, arrangement, or substantial negotiations with regard to the acquisition of the stock of the Predecessor of Distributing is analyzed under §1.355-7 with regard to the actions of officers or directors of Distributing or Controlled, controlling shareholders (as defined in §1.355-7(h)(3)) of Distributing or Controlled, or a person acting with permission of one of those parties. For purposes of the preceding sentence, references in §1.355-7 to Distributing do not include references to a Predecessor of Distributing. Therefore, the actions of officers, directors, or controlling shareholders of a Predecessor of Distributing, or of a person acting with the implicit or explicit permission of one of those parties, are not considered unless those parties otherwise would be treated as acting on behalf of Distributing or Controlled under §1.355-7 (for example, if a Predecessor of Distributing is a controlling shareholder of Distributing).

(iii) Plan Period. For purposes of this section, the term Plan Period means the period that ends immediately after the Distribution and begins on the earliest date on which any pre-Distribution step that is part of the Plan is agreed to or understood, arranged, or substantially negotiated by one or more officers or directors acting on behalf of Distributing or Controlled, by controlling shareholders of Distributing or

Controlled, or by another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders. For purposes of the preceding sentence, references to Distributing and Controlled do not include references to any Predecessor of Distributing, Predecessor of Controlled, or Successor of Distributing or Controlled.

(5) List of definitions. This section uses the following terms, which are defined where indicated--

- (i) Acquiring Owner. Paragraph (d)(1)(i) of this section.
- (ii) Controlled. Paragraph (a)(1) of this section.
- (iii) Distributing. Paragraph (a)(1) of this section.
- (iv) Distributing Gain Limitation Rule. Paragraph (e)(1)(ii) of this section.
- (v) Distribution. Paragraph (a)(1) of this section.
- (vi) Division of Relevant Property Requirement. Paragraph (b)(1)(iii) of this section.
- (vii) Expanded Affiliated Group. Paragraph (b)(2)(ii)(B) of this section.
- (viii) Hypothetical Controlled. Paragraph (e)(2)(i) of this section.
- (ix) Hypothetical D/355(e) Reorganization. Paragraph (e)(2)(i) of this section.
- (x) Plan. Paragraph (a)(4)(ii) of this section.
- (xi) Plan Period. Paragraph (a)(4)(iii) of this section.
- (xii) Planned 50-percent Acquisition. Paragraph (a)(1) of this section.
- (xiii) POD Gain Limitation Rule. Paragraph (e)(1)(ii) of this section.
- (xiv) Potential Predecessor. Paragraph (b)(2)(ii)(A) of this section.
- (xv) Predecessor of Controlled. Paragraph (c)(1) of this section.

- (xvi) Predecessor of Distributing. Paragraph (b)(1) of this section.
- (xvii) Reflection of Basis Requirement. Paragraph (b)(1)(ii)(B) of this section.
- (xviii) Relevant Equity. Paragraph (b)(2)(iv)(A) of this section.
- (xix) Relevant Property. Paragraph (b)(2)(iv)(A) of this section.
- (xx) Relevant Property Requirement. Paragraph (b)(1)(ii)(A) of this section.
- (xxi) Section 381 Transaction. Paragraph (c)(3) of this section.
- (xxii) Separated Property. Paragraph (b)(2)(vii) of this section.
- (xxiii) Statutory Recognition Amount. Paragraph (e)(1)(i) of this section.
- (xxiv) Substitute Asset. Paragraph (b)(2)(vi)(A) of this section.
- (xxv) Successor. Paragraph (c)(2)(i) of this section.
- (xxvi) Successor Transaction. Paragraph (c)(2)(i) of this section.
- (xxvii) Underlying Property. Paragraph (b)(2)(viii) of this section.

(b) Predecessor of Distributing--(1) Definition--(i) In general. For purposes of section 355(e), a Potential Predecessor is a predecessor of Distributing (Predecessor of Distributing) if, taking into account the special rules of paragraph (b)(2) of this section--

(A) Both pre-Distribution requirements of paragraph (b)(1)(ii) of this section are satisfied; and

(B) The post-Distribution requirement of paragraph (b)(1)(iii) of this section is satisfied.

(ii) Pre-Distribution requirements--(A) Relevant Property requirement. The requirement set forth in this paragraph (b)(1)(ii)(A) (Relevant Property Requirement) is satisfied if, before the Distribution, and as part of a Plan, either--

(1) Any Controlled stock distributed in the Distribution was directly or indirectly

acquired (or deemed acquired under the rules set forth in paragraph (b)(2)(x) of this section) by Distributing in exchange for any direct or indirect interest in Relevant Property--

(i) That is held directly or indirectly by Controlled immediately before the Distribution; and

(ii) The gain on which (if any) was not recognized in full at any point during the Plan Period; or

(2) Any Controlled stock that is distributed in the Distribution is Relevant Property of the Potential Predecessor.

(B) Reflection of basis requirement. The requirement set forth in this paragraph (b)(1)(ii)(B) (Reflection of Basis Requirement) is satisfied if any Controlled stock that satisfies the Relevant Property Requirement—

(1) Either—

(i) Had a basis prior to the Distribution that was determined in whole or in part by reference to the basis of any Separated Property; or

(ii) Is Relevant Property of the Potential Predecessor; and

(2) During the Plan Period prior to the Distribution, was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain (if any) on that Controlled stock was recognized in full.

(iii) Post-Distribution requirement. The requirement set forth in this paragraph (b)(1)(iii) (Division of Relevant Property Requirement) is satisfied if, immediately after the Distribution, and as part of a Plan, direct or indirect ownership of the Potential Predecessor's Relevant Property has been divided between Controlled on the one

hand, and Distributing or the Potential Predecessor (or a successor to the Potential Predecessor) on the other hand. For purposes of this paragraph (b)(1)(iii), if Controlled stock that is distributed in the Distribution is Relevant Property of a Potential Predecessor, then Controlled is deemed to have received Relevant Property of the Potential Predecessor.

(2) Additional definitions and rules related to paragraph (b)(1) of this section--(i) References to Distributing and Controlled. For purposes of the Relevant Property Requirement, the Reflection of Basis Requirement, and the Division of Relevant Property Requirement, references to Distributing and Controlled do not include references to any Predecessor of Distributing, Predecessor of Controlled, or Successor of Distributing or Controlled.

(ii) Potential Predecessor--(A) Potential Predecessor definition. The term Potential Predecessor means a corporation, other than Distributing or Controlled, if--

(1) As part of a Plan, the corporation transfers property to a Potential Predecessor, Distributing, or a member of the same Expanded Affiliated Group as Distributing in a Section 381 Transaction; or

(2) Immediately after completion of the Plan, the corporation is a member of the same Expanded Affiliated Group as Distributing.

(B) Expanded Affiliated Group definition. The term Expanded Affiliated Group means an affiliated group (as defined in section 1504 without regard to section 1504(b)).

(iii) Successors of Potential Predecessors. For purposes of the Division of Relevant Property Requirement, if a Potential Predecessor transfers property in a Section 381 Transaction to a corporation (other than Distributing or Controlled) during

the Plan Period, the corporation is a successor to the Potential Predecessor.

(iv) Relevant Property; Relevant Equity--(A) In general. Except as otherwise provided in this paragraph (b)(2)(iv) or in paragraph (b)(2)(v) of this section, the term Relevant Property means any property that was held, directly or indirectly, by the Potential Predecessor during the Plan Period. The term Relevant Equity means Relevant Property that is an equity interest in a corporation or a partnership.

(B) Property held by Distributing. Except as provided in paragraph (b)(2)(iv)(C) of this section, property held directly or indirectly by Distributing (including Controlled stock) is Relevant Property of a Potential Predecessor only to the extent that the property was transferred directly or indirectly to Distributing during the Plan Period, and it was Relevant Property of the Potential Predecessor before the direct or indirect transfer(s). For example, if during the Plan Period a subsidiary corporation of a Potential Predecessor merges into Controlled in a reorganization under section 368(a)(1)(A) and (2)(D), and, as a result, the Potential Predecessor directly or indirectly owns Distributing stock received in the merger, the subsidiary's assets held by Controlled are Relevant Property of that Potential Predecessor.

(C) F reorganizations. For purposes of paragraph (b)(2)(iv)(B) of this section, the transferor and transferee in any reorganization described in section 368(a)(1)(F) (F reorganization) are treated as a single corporation. Therefore, for example, Relevant Property acquired during the Plan Period by a corporation that is a transferor (as to a later F reorganization) is treated as having been acquired directly (and from the same source) by the transferee (as to the later F reorganization) during the Plan Period. In addition, any transfer (or deemed transfer) of assets to Distributing in an

F reorganization will not cause the transferred assets to be treated as Relevant Property.

(v) Stock of Distributing as Relevant Property--(A) In general. For purposes of the Division of Relevant Property Requirement, except as provided in paragraph (b)(2)(v)(B) of this section, stock of Distributing is not Relevant Property (and thus is not Relevant Equity) to the extent that the Potential Predecessor becomes, as part of a Plan, the direct or indirect owner of that stock as the result of the transfer to Distributing of direct or indirect interests in the Potential Predecessor's Relevant Property. For example, stock of Distributing is not Relevant Property if it is acquired by a Potential Predecessor as part of a Plan in an exchange to which section 351(a) applies.

(B) Certain reorganizations. For purposes of the Division of Relevant Property Requirement, stock of Distributing is Relevant Property (and thus Relevant Equity) to the extent that the Potential Predecessor becomes, as part of the Plan, the direct or indirect owner of that stock as the result of a transaction described in section 368(a)(1)(E).

(vi) Substitute Asset--(A) In general. Subject to paragraph (b)(2)(vi)(B) of this section, the term Substitute Asset means any property that is held directly or indirectly by Distributing during the Plan Period and was received, during the Plan Period, in exchange for Relevant Property that was acquired directly or indirectly by Distributing if all gain on the transferred Relevant Property is not recognized on the exchange. For example, property received by Controlled in exchange for Relevant Property in a transaction qualifying under section 1031 is a Substitute Asset. In addition, stock received by Distributing in a distribution qualifying under section 305(a) or section

355(a) on Relevant Equity is a Substitute Asset.

(B) Controlled stock received by Distributing--(1) In general. Except as provided in paragraph (b)(2)(vi)(B)(2) of this section, stock of Controlled received in exchange for a direct or indirect transfer of Relevant Property by Distributing is not a Substitute Asset.

(2) Exception. If the basis in Controlled stock received or deemed received in an exchange described in paragraph (b)(2)(vi)(B)(1) of this section is determined in whole or in part by reference to the basis of Relevant Equity the issuer of which ceases to exist for Federal income tax purposes under the Plan, that Controlled stock constitutes a Substitute Asset. See paragraph (b)(2)(x) of this section.

(C) Treatment as Relevant Property. For purposes of this section, a Substitute Asset is treated as Relevant Property with the same ownership and transfer history as the Relevant Property for which (or with respect to which) it was received.

(vii) Separated Property. The term Separated Property means each item of Relevant Property that is described in the Relevant Property Requirement (regardless of whether the fair market value of the Relevant Property exceeds its adjusted basis). However, if Relevant Equity is Separated Property, Underlying Property associated with that Relevant Equity is not treated as Separated Property. In addition, if Distributing directly or indirectly acquires Relevant Equity in a transaction in which gain is recognized in full, Underlying Property associated with that Relevant Equity is not treated as Separated Property.

(viii) Underlying Property. The term Underlying Property means property directly or indirectly held by a corporation or partnership any equity interest in which is Relevant Equity.

(ix) Multiple Predecessors of Distributing. If there are multiple Potential Predecessors that satisfy the pre-Distribution requirements and post-Distribution requirement of paragraph (b)(1) of this section, each of those Potential Predecessors is a Predecessor of Distributing. For example, a Potential Predecessor that transfers property to a Predecessor of Distributing without full recognition of gain (and that otherwise meets the requirements of paragraph (b)(1) of this section) is also a Predecessor of Distributing if the applicable transfer occurred as part of a Plan that existed at the time of such transfer.

(x) Deemed exchanges. For purposes of paragraph (b)(1)(ii) of this section (regarding the Relevant Property Requirement and the Reflection of Basis Requirement) and paragraph (b)(2)(vi) of this section (regarding Substitute Assets), Distributing is treated as acquiring Controlled stock in exchange for a direct or indirect interest in Relevant Property if the basis of Distributing in that Controlled stock, immediately after a transfer of the Relevant Property, is determined in whole or in part by reference to the basis of that Relevant Property immediately before the transfer. For example, if a corporation transfers Relevant Property to Controlled in exchange for Distributing stock in a transaction that qualifies as a reorganization under section 368(a)(1)(C), then, for purposes of paragraphs (b)(1)(ii) and (b)(2)(vi) of this section, Distributing is treated as acquiring Controlled stock in exchange for a direct or indirect interest in Relevant Property. See §1.358-6(c)(1).

(c) Additional definitions--(1) Predecessor of Controlled. Solely for purposes of applying paragraph (f) of this section, a corporation is a predecessor of Controlled (Predecessor of Controlled) if, before the Distribution, it transfers property to Controlled

in a Section 381 Transaction as part of a Plan. Other than for the purpose described in the preceding sentence, no corporation can be a Predecessor of Controlled. If multiple corporations satisfy the requirements of this paragraph (c)(1), each of those corporations is a Predecessor of Controlled. For example, a corporation that transfers property to a Predecessor of Controlled in a Section 381 Transaction is also a Predecessor of Controlled if the Section 381 Transaction occurred as part of a Plan that existed at the time of such transaction.

(2) Successors--(i) In general. For purposes of section 355(e), a successor (Successor) of Distributing or of Controlled is a corporation to which Distributing or Controlled, respectively, transfers property in a Section 381 Transaction after the Distribution (Successor Transaction).

(ii) Determination of Successor status. More than one corporation may be a Successor of Distributing or Controlled. For example, if Distributing transfers property to another corporation (X) in a Section 381 Transaction, and X transfers property to another corporation (Y) in a Section 381 Transaction, then each of X and Y is a Successor of Distributing. In this case, the determination of whether Y is a Successor of Distributing is made after the determination of whether X is a Successor of Distributing.

(3) Section 381 Transaction. The term Section 381 Transaction means a transaction to which section 381 applies.

(d) Special acquisition rules--(1) Deemed acquisitions of stock in Section 381 Transactions--(i) Rule. This paragraph (d)(1)(i) applies to each shareholder of the acquiring corporation immediately before a Section 381 Transaction (Acquiring Owner).

Each Acquiring Owner is treated for purposes of this section as acquiring, in the Section 381 Transaction, stock representing an interest in the distributor or transferor corporation, to the extent that the Acquiring Owner's interest in the acquiring corporation immediately after the Section 381 Transaction exceeds the Acquiring Owner's direct or indirect interest in the distributor or transferor corporation immediately before the Section 381 Transaction.

(ii) Example. The example set forth in this paragraph (d)(1)(ii) illustrates the application of the deemed acquisition rule in paragraph (d)(1)(i) of this section. Assume that A held all of the stock of Distributing, Distributing held a 25-percent interest in a Predecessor of Distributing, and A held no direct interest, or other indirect interest, in the Predecessor of Distributing immediately before a Section 381 Transaction in which the Predecessor of Distributing transfers its assets to Distributing. In the Section 381 Transaction, the Predecessor of Distributing's shareholders (other than Distributing) collectively receive a 10-percent interest in Distributing (reducing A's interest in Distributing to 90 percent). Under paragraph (d)(1)(i) of this section, A is treated as acquiring in the Section 381 Transaction stock representing a 65-percent interest in the Predecessor of Distributing. This is because A's 90-percent interest in Distributing (the acquiring corporation in the Section 381 Transaction) immediately after the Section 381 Transaction exceeds A's 25-percent interest (held indirectly through Distributing) in the Predecessor of Distributing (the transferor corporation in the Section 381 Transaction) immediately before the Section 381 Transaction by 65 percent. Similarly, each Acquiring Owner of a Successor of Distributing is treated as acquiring, in the Successor Transaction, stock of Distributing, to the extent that the Acquiring Owner's interest in the

Successor of Distributing immediately after the Successor Transaction exceeds the Acquiring Owner's direct or indirect interest in Distributing immediately before the Successor Transaction.

(2) Deemed acquisitions of stock after Section 381 Transactions. For purposes of this section, after a Section 381 Transaction (including a Successor Transaction), an acquisition of stock of an acquiring corporation (including a deemed stock acquisition under paragraph (d)(1)(i) of this section) is treated also as an acquisition of an interest in the stock of the distributor or transferor corporation. For example, an acquisition of the stock of Distributing that occurs after a Section 381 Transaction is treated not only as an acquisition of the stock of Distributing, but also as an acquisition of the stock of any Predecessor of Distributing whose assets were acquired by Distributing in the prior Section 381 Transaction. Similarly, an acquisition of the stock of a Successor of Distributing that occurs after the Successor Transaction is treated not only as an acquisition of the stock of the Successor of Distributing, but also as an acquisition of the stock of Distributing.

(3) Separate counting for Distributing and each Predecessor of Distributing. The measurement of whether one or more persons have acquired stock of any specific corporation in a Planned 50-percent Acquisition is made separately from the measurement of any potential Planned 50-percent Acquisition of any other corporation. Therefore, there may be a Planned 50-percent Acquisition of a Predecessor of Distributing even if there is no Planned 50-percent Acquisition of Distributing. Similarly, there may be a Planned 50-percent Acquisition of Distributing even if there is no Planned 50-percent Acquisition of a Predecessor of Distributing.

(e) Special rules for limiting gain recognition--(1) Overview--(i) Gain limitation.

This paragraph (e) provides rules that limit the amount of gain that must be recognized by Distributing by reason of section 355(e) to an amount that is less than the amount that Distributing otherwise would be required to recognize under section 355(c)(2) or section 361(c)(2) (Statutory Recognition Amount) in certain cases involving one or more Predecessors of Distributing.

(ii) Multiple Planned 50-percent Acquisitions. If there are Planned 50-percent Acquisitions of multiple corporations (for example, two Predecessors of Distributing), Distributing must recognize the Statutory Recognition Amount with respect to each such corporation, subject to the limitations in paragraph (e)(2) of this section relating to a Planned 50-percent Acquisition of a Predecessor of Distributing (POD Gain Limitation Rule) and paragraph (e)(3) of this section relating to a Planned 50-percent Acquisition of Distributing (Distributing Gain Limitation Rule), if applicable. The POD Gain Limitation Rule and the Distributing Gain Limitation Rule are applied separately to the Planned 50-percent Acquisition of each such corporation to determine the amount of gain required to be recognized.

(iii) Statutory Recognition Amount limit; Section 336(e). Paragraph (e)(4) of this section sets forth an overall gain limitation based on the Statutory Recognition Amount. Paragraph (e)(5) of this section clarifies the availability of an election under section 336(e) with regard to certain Distributions.

(2) Planned 50-percent Acquisition of a Predecessor of Distributing--(i) In general. If there is a Planned 50-percent Acquisition of a Predecessor of Distributing, the amount of gain recognized by Distributing by reason of section 355(e) as a result of

the Planned 50-percent Acquisition is limited to the amount of gain, if any, that Distributing would have recognized if, immediately before the Distribution, Distributing had engaged in the following transaction: Distributing transferred all Separated Property received from the Predecessor of Distributing to a newly formed corporation (Hypothetical Controlled) in exchange solely for stock of Hypothetical Controlled in a reorganization under section 368(a)(1)(D) and then distributed the stock of Hypothetical Controlled to the shareholders of Distributing in a transaction to which section 355(e) applied (Hypothetical D/355(e) Reorganization). The computation in this paragraph (e)(2)(i) is applied regardless of whether Distributing actually directly held the Separated Property.

(ii) Operating rules. For purposes of applying paragraph (e)(2)(i) of this section, the following rules apply:

(A) Separated Property other than Controlled stock. Each of the basis and the fair market value of Separated Property other than stock of Controlled treated as transferred by Distributing to a Hypothetical Controlled in a Hypothetical D/355(e) Reorganization equals the basis and the fair market value, respectively, of such property in the hands of Controlled immediately before the Distribution.

(B) Controlled stock that is Separated Property. Each of the basis and the fair market value of the stock of Controlled that is Separated Property treated as transferred by Distributing to a Hypothetical Controlled in a Hypothetical D/355(e) Reorganization equals the basis and the fair market value, respectively, of such stock in the hands of Distributing immediately before the Distribution.

(C) Anti-duplication rule. A Predecessor of Distributing's Separated Property is

taken into account for purposes of applying this paragraph (e)(2) only to the extent such property was not taken into account by Distributing in a Hypothetical D/355(e) Reorganization with respect to another Predecessor of Distributing. Further, appropriate adjustments must be made to prevent other duplicative inclusions of section 355(e) gain under this paragraph (e) reflecting the same economic gain.

(3) Planned 50-percent Acquisition of Distributing. This paragraph (e)(3) applies if there is a Planned 50-percent Acquisition of Distributing. In that case, the amount of gain recognized by Distributing by reason of section 355(e) as a result of the Planned 50-percent Acquisition is limited to the excess, if any, of the Statutory Recognition Amount over the amount of gain, if any, that Distributing would have been required to recognize under paragraphs (e)(1)(ii) and (e)(2) of this section if there had been a Planned 50-percent Acquisition of every Predecessor of Distributing, but not of Distributing or Controlled. For purposes of this paragraph (e)(3), references to Distributing are not references to a Predecessor of Distributing.

(4) Gain recognition limited to Statutory Recognition Amount. The sum of the amounts required to be recognized by Distributing under section 355(e) (taking into account the POD Gain Limitation Rule and the Distributing Gain Limitation Rule) with regard to a single Distribution cannot exceed the Statutory Recognition Amount. In addition, Distributing may choose not to apply the POD Gain Limitation Rule or the Distributing Gain Limitation Rule to a Distribution, and instead may recognize the Statutory Recognition Amount. Distributing indicates its choice to apply the preceding sentence by reporting the Statutory Recognition Amount on its original or amended Federal income tax return for the year of the Distribution.

(5) Section 336(e) election. Distributing is not eligible to make a section 336(e) election (as defined in §1.336-1(b)(11)) with respect to a Distribution to which this section applies unless Distributing would, absent the making of a section 336(e) election, recognize the Statutory Recognition Amount with respect to the Distribution (taking into account the POD Gain Limitation Rule and the Distributing Gain Limitation Rule) without regard to the final two sentences of paragraph (e)(4) of this section. See §§1.336-1 through 1.336-5 for additional requirements with regard to a section 336(e) election.

(f) Predecessor or Successor as a member of the affiliated group. For purposes of section 355(e)(2)(C), if a corporation transfers its assets to a member of the same Expanded Affiliated Group in a Section 381 Transaction, the transferor will be treated as continuing in existence within the same Expanded Affiliated Group.

(g) Inapplicability of section 355(f) to certain intra-group Distributions--(1) In general. Section 355(f) does not apply to a Distribution if there is a Planned 50-percent Acquisition of a Predecessor of Distributing (but not of Distributing, Controlled, or their Successors), except as provided in paragraph (g)(2) of this section. Therefore, except as provided in paragraph (g)(2) of this section, section 355 (or so much of section 356 as relates to section 355) and the regulations under sections 355 and 356, including the POD Gain Limitation Rule, apply, without regard to section 355(f), to a Distribution within an affiliated group (as defined in section 1504(a)) if the Distribution and the Planned 50-percent Acquisition of the Predecessor of Distributing are part of a Plan. For purposes of this paragraph (g)(1), references to a Distribution (and Distributing and Controlled) include references to a distribution (and Distributing and Controlled) to

which section 355 would apply but for the application of section 355(f).

(2) Alternative application of section 355(f). Distributing may choose not to apply paragraph (g)(1) of this section to each Distribution (that occurs under a Plan) to which section 355(f) would otherwise apply absent paragraph (g)(1) of this section. Instead, Distributing may apply section 355(f) to all such Distributions according to its terms, but only if all members of the same Expanded Affiliated Group report consistently the Federal income tax consequences of the Distributions that are part of the Plan (determined without regard to section 355(f)). In such a case, neither the POD Gain Limitation Rule nor the Distributing Gain Limitation Rule is available with regard to any applicable Distribution. Distributing indicates its choice to apply section 355(f) consistently to all applicable Distributions by reporting the Federal income tax consequences of each Distribution in accordance with section 355(f) on its Federal income tax return for the year of the Distribution.

(h) Examples. The following examples illustrate the principles of this section. Unless the facts indicate otherwise, assume throughout these examples that: Distributing (D) owns all the stock of Controlled (C), and none of the shares of C held by D has a built-in loss; D distributes the stock of C in a Distribution to which section 355(d) does not apply; X, Y, and Z are individuals; each of D, D1, C, P, P1, P2, and R is a corporation having one class of stock outstanding, and none is a member of a consolidated group; and each transaction that is part of a Plan defined in this section is respected as a separate transaction under general Federal income tax principles. No inference should be drawn from any example concerning whether any requirements of section 355 are satisfied other than those of section 355(e) or whether any general

Federal income tax principles (including the step transaction doctrine) are implicated by the example:

(1) Example 1: Predecessor of D and Planned 50-Percent Acquisition of P--(i) Facts. X owns 100% of the stock of P, which holds multiple assets. Y owns 100% of the stock of D. The following steps occur as part of a Plan: P merges into D in a reorganization under section 368(a)(1)(A). Immediately after the merger, X and Y own 10% and 90%, respectively, of the stock of D. D then contributes to C one of the assets (Asset 1) acquired from P in the merger. At the time of the contribution, Asset 1 has a basis of \$40x and a fair market value of \$110x. In exchange for Asset 1, D receives additional C stock and \$10x. D distributes the stock of C (but not the cash) to X and Y, pro rata. The contribution and Distribution constitute a reorganization under section 368(a)(1)(D), and D recognizes \$10x of gain under section 361(b) on the contribution. Immediately before the Distribution, taking into account the \$10x of gain recognized by D on the contribution, Asset 1 has an adjusted basis of \$50x under section 362(b) and a fair market value of \$110x, and the stock of C held by D has a basis of \$100x and a fair market value of \$200x.

(ii) Analysis--(A) P is a Predecessor of D. Under paragraph (b)(1) of this section, P is a Predecessor of D. First, P is a Potential Predecessor because, as part of a Plan, P transferred property to D in a Section 381 Transaction. See paragraph (b)(2)(ii)(A)(1) of this section. Second, both of the pre-Distribution requirements and the post-Distribution requirement are satisfied. The Relevant Property Requirement is satisfied because, immediately before the Distribution and as part of a Plan, C holds P Relevant Property (Asset 1) the gain on which was not recognized in full at any point during the Plan Period, and some of the C stock distributed in the Distribution was acquired by D in exchange for Asset 1. See paragraph (b)(1)(ii)(A)(1) of this section. The Reflection of Basis Requirement is satisfied because that C stock had a basis prior to the Distribution that was determined in whole or in part by reference to the basis of Separated Property (Asset 1), and was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain on that C stock was recognized in full during the Plan Period prior to the Distribution. See paragraph (b)(1)(ii)(B) of this section. The Division of Relevant Property Requirement is satisfied because immediately after the Distribution, D continues to hold Relevant Property of P, and therefore, as part of a Plan, P's Relevant Property has been divided between C and D. See paragraph (b)(1)(iii) of this section.

(B) Planned 50-percent Acquisition of P. Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of P as a result of the merger of P into D. Accordingly, there has been a Planned 50-percent Acquisition of P.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$100x of gain (\$200x of aggregate fair market value minus \$100x of aggregate basis of the C stock held by D), the Statutory Recognition

Amount described in section 361(c)(2). However, under the POD Gain Limitation Rule, D's gain recognized by reason of the Planned 50-percent Acquisition of P will not exceed \$60x, an amount equal to the amount of gain D would have recognized had D transferred Asset 1 (Separated Property) to a newly formed corporation (C1) solely for C1 stock and distributed the C1 stock to D's shareholders in a Hypothetical D/355(e) Reorganization. See paragraph (e)(2)(i) of this section. For purposes of the computation in this paragraph (h)(1)(ii)(C), the basis and fair market value of Asset 1 equal the basis and fair market value of Asset 1 in the hands of C immediately before the Distribution. See paragraph (e)(2)(ii)(A) of this section. Under section 361(c)(2), D would recognize \$60x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$110x fair market value over the \$50x basis). Therefore, D recognizes \$60x of gain (in addition to the \$10x of gain recognized under section 361(b)).

(iii) Plan not in existence at time of acquisition of Potential Predecessor's property. The facts are the same as in paragraph (h)(1)(i) of this section (Example 1) except that the merger of P into D occurred before the existence of a Plan. Even though D transferred P property (Asset 1) to C, Asset 1 was not Relevant Property of P because P did not hold Asset 1 during the Plan Period. See paragraphs (b)(2)(iv) and (a)(4)(iii) of this section. Because Asset 1 is not Relevant Property, D did not receive C stock distributed in the Distribution in exchange for Relevant Property when it contributed Asset 1 to C, none of the distributed C stock had a basis prior to the Distribution that was determined in whole or in part by reference to the basis of Separated Property, and C did not hold Relevant Property immediately before the Distribution. Further, Relevant Property of P has not been divided. Therefore, P is not a Predecessor of D.

(2) Example 2: Planned 50-percent Acquisition of D, but not Predecessor of D--(i) Facts. X owns 100% of the stock of P, which holds multiple assets. Y owns 100% of the stock of D. The following steps occur as part of a Plan: P merges into D in a reorganization under section 368(a)(1)(A). Immediately after the merger, X and Y own 90% and 10%, respectively, of the stock of D. D then contributes to C one of the assets (Asset 1) acquired from P in the merger. In exchange for Asset 1, D receives additional C stock. D distributes the stock of C to X and Y, pro rata. The contribution and Distribution constitute a reorganization under section 368(a)(1)(D). Immediately before the Distribution, Asset 1 has a basis of \$50x and a fair market value of \$110x, and the stock of C held by D has a basis of \$120x and a fair market value of \$200x.

(ii) Analysis--(A) P is a Predecessor of D. Under paragraph (b)(1) of this section, P is a Predecessor of D. First, P is a Potential Predecessor because, as part of a Plan, P transferred property to D in a Section 381 Transaction. See paragraph (b)(2)(ii)(A)(1) of this section. Second, both of the pre-Distribution requirements and the post-Distribution requirement are satisfied. The Relevant Property Requirement is satisfied because, immediately before the Distribution and as part of a Plan, C holds P Relevant Property (Asset 1) the gain on which was not recognized in full at any point during the Plan Period, and some of the C stock distributed in the Distribution was acquired by D in exchange for Asset 1. See paragraph (b)(1)(ii)(A)(1) of this section. The Reflection of

Basis Requirement is satisfied because that C stock had a basis prior to the Distribution that was determined in whole or in part by reference to the basis of Separated Property (Asset 1), and was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain on that C stock was recognized in full during the Plan Period prior to the Distribution. See paragraph (b)(1)(ii)(B) of this section. The Division of Relevant Property Requirement is satisfied because immediately after the Distribution, D continues to hold Relevant Property of P, and therefore, as part of a Plan, P's Relevant Property has been divided between C and D. See paragraph (b)(1)(iii) of this section.

(B) Planned 50-percent Acquisition of D. Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 10% of the voting power and value of P as a result of the merger of P into D. The 10% acquisition of P stock does not cause section 355(e) gain recognition or cause application of the POD Gain Limitation Rule because there has not been a Planned 50-percent Acquisition of P. X acquires 90% of the voting power and value of D as a result of the merger of P into D. Accordingly, there has been a Planned 50-percent Acquisition of D. This Planned 50-percent Acquisition implicates section 355(e) and results in gain recognition, subject to the rules of paragraph (e) of this section.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$80x of gain (\$200x of fair market value minus \$120x of basis of the C stock held by D), the Statutory Recognition Amount described in section 361(c)(2). However, under the Distributing Gain Limitation Rule, D's gain recognized by reason of the Planned 50-percent Acquisition of D will not exceed \$20x, the excess of the Statutory Recognition Amount (\$80x) over the amount of gain that D would have been required to recognize under the POD Gain Limitation Rule if there had been a Planned 50-percent Acquisition of P but not D or C (\$60x). See paragraph (e)(3) of this section. The hypothetical gain limitation under the POD Gain Limitation Rule equals the amount D would have recognized had it transferred Asset 1 (Separated Property) to a newly formed corporation (C1) solely for stock and distributed the C1 stock in a Hypothetical D/355(e) Reorganization. See paragraph (e)(2)(i) of this section. Under section 361(c)(2), D would recognize \$60x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$110x fair market value over the \$50x basis). Therefore, D recognizes \$20x of gain (\$80x - \$60x).

(3) Example 3: Predecessor of D owns C stock--(i) Facts. X owns 100% of the stock of P, which holds multiple assets, including Asset 2. Y owns 100% of the stock of D. P owns 35% of the stock of C (Block 1), and D owns the remaining 65% of the C stock (Block 2). The following steps occur as part of a Plan: P merges into D in a reorganization under section 368(a)(1)(A), and D immediately thereafter distributes all of the C stock to X and Y pro rata. Immediately after the merger, X and Y own 10% and 90%, respectively, of the D stock, and, prior to the Distribution, D owns Block 1 with a basis of \$30x and a fair market value of \$35x, and Block 2 with a basis of \$10x and a fair market value of \$65x. D continues to hold Asset 2.

(ii) Analysis--(A) P is a Predecessor of D. Under paragraph (b)(1) of this section, P is a Predecessor of D. First, P is a Potential Predecessor because, as part of a Plan, P transferred property to D in a Section 381 Transaction. See paragraph (b)(2)(ii)(A)(1) of this section. Second, both of the pre-Distribution requirements and the post-Distribution requirement are satisfied. The Relevant Property Requirement is satisfied because some of the C stock distributed in the Distribution (Block 1) was Relevant Property of P. See paragraph (b)(1)(ii)(A)(2) of this section. The Reflection of Basis Requirement is satisfied because Block 1 of the C stock is Relevant Property of P, and was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain on that C stock was recognized in full during the Plan Period prior to the Distribution. See paragraph (b)(1)(ii)(B) of this section. The Division of Relevant Property Requirement is satisfied because some of the C stock distributed in the Distribution was Relevant Property of P, and therefore C is deemed to have received Relevant Property of P, and D continues to hold Relevant Property of P immediately after the Distribution. See paragraph (b)(1)(iii) of this section. Therefore, as part of a Plan, P's Relevant Property has been divided between C and D.

(B) Planned 50-percent Acquisition of P. Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of P as a result of the merger of P into D. Accordingly, there has been a Planned 50-percent Acquisition of P.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$60x of gain (\$100x of fair market value minus \$40x of basis of the C stock held by D), the Statutory Recognition Amount under section 355(c)(2). However, under the POD Gain Limitation Rule, D's gain recognized by reason of the Planned 50-percent Acquisition of P will not exceed \$5x, an amount equal to the amount D would have recognized had it transferred Block 1 of the C stock (Separated Property) to a newly formed corporation (C1) solely for stock and distributed the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. See paragraph (e)(2)(i) of this section. Because Relevant Equity (Block 1 of the C stock) is Separated Property, Underlying Property associated with that Relevant Equity is not treated as Separated Property. See paragraph (b)(2)(vii) of this section. For purposes of the computation in this paragraph (h)(3)(ii)(C), the basis and fair market value of the Block 1 C stock equal its basis and fair market value in the hands of D immediately before the Distribution. See paragraph (e)(2)(ii)(A) of this section. Under section 361(c)(2), D would recognize \$5x of gain, an amount equal to the gain in the hypothetical C1 stock (\$35x fair market value - \$30x basis). Therefore, D recognizes \$5x of gain.

(4) Example 4: C stock as Substitute Asset--(i) Facts. X owns 100% of the stock of P, which owns multiple assets, including 100% of the stock of R and Asset 2. Y owns 100% of the stock of D. The following steps occur as part of a Plan: P merges into D in a reorganization under section 368(a)(1)(A) (P-D reorganization). Immediately after the merger, X and Y own 10% and 90%, respectively, of the stock of D. D then causes R to transfer all of its assets to C and liquidate in a reorganization under section 368(a)(1)

(R-C reorganization). At the time of the P-D reorganization, the R stock has a basis of \$40x and a fair market value of \$110x. D distributes the stock of C to X and Y, pro rata. D continues to directly hold Asset 2. Immediately before the Distribution, the C stock held by D that was deemed received in the R-C reorganization (Block 1) has a basis of \$40x and a fair market value of \$110x, and all of the stock of C held by D has a basis of \$100x and a fair market value of \$200x.

(ii) Analysis--(A) P is a Predecessor of D. Under paragraph (b)(1) of this section, P is a Predecessor of D. First, P is a Potential Predecessor because, as part of a Plan, P transferred property to D in a Section 381 Transaction. See paragraph (b)(2)(ii)(A)(1) of this section. Second, both pre-Distribution requirements and the post-Distribution requirement are satisfied. The Relevant Property Requirement is satisfied because, for the following two reasons, some of the C stock distributed in the Distribution (Block 1) was Relevant Property of P. D is treated as acquiring Block 1 of the C stock in exchange for a direct or indirect interest in R stock (that is, Relevant Property) in the R-C reorganization because the basis of D in that C stock immediately after a transfer of the R stock (in the liquidation of R) is determined in whole or in part by reference to the basis of the R stock immediately before the transfer. See paragraph (b)(2)(x) of this section. Further, because the basis in Block 1 of the C stock is determined in whole or in part by reference to the basis of Relevant Equity (the R stock) the issuer of which ceases to exist for Federal income tax purposes under the Plan, Block 1 of the C stock is a Substitute Asset, and is therefore treated as Relevant Property with the same ownership and transfer history as the R stock. See paragraph (b)(2)(vi)(B)(2) of this section. The Reflection of Basis Requirement is satisfied because Block 1 of the C stock is Relevant Property of P, and was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain on that C stock was recognized in full during the Plan Period prior to the Distribution. See paragraph (b)(1)(ii)(B) of this section. The Division of Relevant Property Requirement is satisfied because some of the C stock distributed in the Distribution was Relevant Property of P, and therefore C is deemed to have received Relevant Property of P, and immediately after the Distribution, D continues to hold Asset 2, which is Relevant Property of P. See paragraph (b)(1)(iii) of this section. Therefore, as part of a Plan, P's Relevant Property has been divided between C and D.

(B) Planned 50-percent Acquisition of P. Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of P as a result of the P-D reorganization. Accordingly, there has been a Planned 50-percent Acquisition of P.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$100x of gain (\$200x of fair market value minus \$100x of basis of all C stock held by D), the Statutory Recognition Amount described in section 355(c)(2). However, under the POD Gain Limitation Rule, D's gain recognized by reason of the Planned 50-percent Acquisition of P will not exceed \$70x, an amount equal to the amount D would have recognized had it transferred Block 1 of the C stock (Separated Property) to a newly formed corporation (C1) solely for stock and distributed

the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. See paragraph (e)(2)(i) of this section. Because Relevant Equity (Block 1 of the C stock) is Separated Property, Underlying Property associated with that Relevant Equity is not treated as Separated Property. See paragraph (b)(2)(vii) of this section. Under section 361(c)(2), D would recognize \$70x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$110x fair market value over the \$40x basis). Therefore, D recognizes \$70x of gain.

(5) Example 5: Section 351 transaction--(i) Facts. X owns 100% of the stock of P, which holds multiple assets, including Asset 1, Asset 2, and Asset 3. Y owns 100% of the stock of D. The following steps occur as part of a Plan: P transfers Asset 1 and Asset 2 to D and Y transfers property to D in an exchange qualifying under section 351. Immediately after the exchange, P and Y own 10% and 90%, respectively, of the stock of D. D then contributes Asset 1 to C in exchange for additional C stock. D distributes all of the stock of C to P and Y, pro rata. D continues to directly hold Asset 2, and P continues to directly hold Asset 3. The contribution and Distribution constitute a reorganization under section 368(a)(1)(D). Immediately before the Distribution, Asset 1 has a basis of \$40x and a fair market value of \$110x, and the stock of C held by D has a basis of \$100x and a fair market value of \$200x. Following the Distribution, and as part of the same Plan, Z acquires 51% of the P stock.

(ii) Analysis--P is not a Predecessor of D. Under paragraph (b)(1) of this section, P is not a Predecessor of D. P is not a Potential Predecessor because P did not transfer property to a Potential Predecessor, D, or a member of the same Expanded Affiliated Group as D in a Section 381 Transaction and P is not a member of the same Expanded Affiliated Group as D immediately after completion of the Plan. See paragraph (b)(2)(ii) of this section. Thus, P cannot be a Predecessor of D. See paragraph (b)(1)(i) of this section.

(6) Example 6: Section 351 transaction after an acquisition of P--(i) Facts. X owns 100% of the stock of P, which holds multiple assets, including Asset 1 and Asset 2. Y owns 100% of the stock of D, D owns 100% of the stock of D1, and D1 owns 100% of the stock of C. D files a consolidated return for the affiliated group of which it is the common parent. The following steps occur as part of a Plan: D acquires 100% of the stock of P from X. P transfers Asset 1 and Asset 2 to D1 for D1 stock in an exchange qualifying under section 351. See §1.1502-34. D1 contributes Asset 1 to C in exchange for additional C stock. D1 distributes all of the stock of C to D in exchange for D1 stock (First Distribution). D then distributes all of the stock of C to Y (Second Distribution). D1 continues to directly hold Asset 2. Immediately before the First Distribution, Asset 1 has a basis of \$10x and a fair market value of \$60x, and the stock of C held by D1 has a basis of \$100x and a fair market value of \$200x.

(ii) Analysis--(A) P is a Predecessor of D1. Under paragraph (b)(1) of this section, P is a Predecessor of D1. First, P is a Potential Predecessor of D1 because P is a member of the same Expanded Affiliated Group as D1 immediately after completion of the Plan. See paragraph (b)(2)(ii)(A)(2) of this section. The Relevant Property

Requirement is satisfied because, immediately before the First Distribution and as part of a Plan, C holds P Relevant Property (Asset 1) the gain on which was not recognized in full at any point during the Plan Period, and some of the C stock distributed in the First Distribution was acquired by D1 in exchange for Asset 1. See paragraph (b)(1)(ii)(A)(1) of this section. The Reflection of Basis Requirement is satisfied because that C stock had a basis prior to the First Distribution that was determined in whole or in part by reference to the basis of Separated Property (Asset 1), and was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain on that C stock was recognized in full prior to the First Distribution. See paragraph (b)(1)(ii)(B) of this section. The Division of Relevant Property Requirement is satisfied because immediately after the First Distribution, each of C, on the one hand, and P or D1, on the other hand, continues to hold Relevant Property of P, and therefore, as part of a Plan, P's Relevant Property has been divided between C and D1. See paragraph (b)(1)(iii) of this section.

(B) Planned 50-percent Acquisition of P. D has acquired stock representing 100% of the voting power and value of P. Accordingly, there has been a Planned 50-percent Acquisition of P.

(C) Gain on First Distribution. Because there is a Planned 50-percent Acquisition of a Predecessor of Distributing (but not of Distributing, Controlled, or their Successors), section 355(f) will not apply to the First Distribution unless D and D1 choose to have section 355(f) apply. See paragraph (g) of this section. As a result, section 355, including the POD Gain Limitation Rule, will apply to the First Distribution. Under the POD Gain Limitation Rule, D1's gain recognized by reason of the Planned 50-percent Acquisition of P will not exceed \$50x, an amount equal to the amount D1 would have recognized had it transferred Asset 1 (Separated Property) to a newly formed corporation (C1) solely for stock and distributed the C1 stock to D1 shareholders in a Hypothetical D/355(e) Reorganization. See paragraph (e)(2)(i) of this section. Under section 361(c)(2), D1 would recognize \$50x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$60x fair market value over the \$10x basis). Therefore, D1 recognizes \$50x of gain. Under paragraph (g)(2) of this section, however, D and D1 may choose to apply section 355(f) to the First Distribution as an exception to the general application of paragraph (g)(1) of this section. By application of section 355(f), section 355 (including the POD Gain Limitation Rule) would not apply to the First Distribution. Therefore, D1 would be required to recognize \$100x of gain (excess of the \$200x fair market value over the \$100x basis of C stock held by D1) under section 311(b), and D would be treated under section 302(d) as receiving a distribution of \$200x to which section 301 applies.

(D) P is not a Predecessor of D. Under paragraph (b)(1) of this section, P is not a Predecessor of D. First, P is a Potential Predecessor of D because P is a member of the same Expanded Affiliated Group as D immediately after completion of the Plan. See paragraph (b)(2)(ii)(A)(2) of this section. However, although the Relevant Property Requirement is satisfied, the Reflection of Basis Requirement is not satisfied. The Relevant Property Requirement is satisfied because, immediately before the Second

Distribution and as part of a Plan, C holds P Relevant Property (Asset 1) the gain on which was not recognized in full at any point during the Plan Period, and some of the C stock distributed in the Second Distribution was indirectly acquired by D in exchange for Asset 1. See paragraph (b)(1)(ii)(A)(1) of this section. However, regardless of whether D and D1 choose under paragraph (g)(2) of this section to have section 355(f) apply to the First Distribution, the Reflection of Basis Requirement cannot be satisfied. If section 355(f) applies to the First Distribution, then all of the C stock will have been transferred in a transaction in which the gain on the C stock was recognized in full during the Plan Period prior to the Second Distribution. If section 355(f) does not apply to the First Distribution, then all of the C stock will have been transferred in a distribution to which section 355(e) applied during the Plan Period prior to the Second Distribution. Because not all of the pre-Distribution and post-Distribution requirements are satisfied, P cannot be a Predecessor of D.

(7) Example 7: Sequential Predecessors--(i) Facts. X owns 100% of P1, which holds multiple assets, including Asset 1 and Asset 2. Y owns 100% of P2, which holds Asset 3, and Z owns 100% of D. The following steps occur as part of a Plan: P1 merges into P2 in a reorganization under 368(a)(1)(A) (P1-P2 reorganization). Immediately after the merger, X and Y own 10% and 90%, respectively, of the stock of P2. P2 then merges into D in a reorganization under 368(a)(1)(A) (P2-D reorganization). Immediately after the merger, X, Y, and Z own 1%, 9%, and 90%, respectively, of the stock of D. D then contributes Asset 1 to C in exchange for additional C stock, and retains Asset 2 and Asset 3. D distributes all of the stock of C to X, Y, and Z, pro rata. Immediately before the Distribution, Asset 1 has a basis of \$40x and a fair market value of \$100x, and the stock of C held by D has a basis of \$100x and a fair market value of \$200x.

(ii) Analysis--(A) P2 is a Predecessor of D. Under paragraph (b)(1) of this section, P2 is a Predecessor of D. First, P2 is a Potential Predecessor because, as part of a Plan, P2 transferred property to D in a Section 381 Transaction. See paragraph (b)(2)(ii)(A)(1) of this section. Second, both pre-Distribution requirements and the post-Distribution requirement are satisfied. The Relevant Property Requirement is satisfied because, immediately before the Distribution and as part of a Plan, C holds P2 Relevant Property (Asset 1) the gain on which was not recognized in full at any point during the Plan Period, and some of the C stock distributed in the Distribution was acquired by D in exchange for Asset 1. See paragraph (b)(1)(ii)(A)(1) of this section. The Reflection of Basis Requirement is satisfied because that C stock had a basis prior to the Distribution that was determined in whole or in part by reference to the basis of Separated Property (Asset 1), and was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain on that C stock was recognized in full during the Plan Period prior to the Distribution. See paragraph (b)(1)(ii)(B) of this section. The Division of Relevant Property Requirement is satisfied because immediately after the Distribution, D continues to hold P2 Relevant Property (Asset 2 and Asset 3), and therefore, as part of a Plan, P2's Relevant Property has been divided between C and D. See paragraph (b)(1)(iii) of this section.

(B) P1 is a Predecessor of D. Under paragraph (b)(1) of this section, P1 is a Predecessor of D. First, P1 is a Potential Predecessor because, as part of a Plan, P1 transferred property to a Potential Predecessor (P2) in a Section 381 Transaction. See paragraph (b)(2)(ii)(A)(1) of this section. Second, both pre-Distribution requirements and the post-Distribution requirement are satisfied. The Relevant Property Requirement is satisfied because, immediately before the Distribution and as part of a Plan, C holds P1 Relevant Property (Asset 1) the gain on which was not recognized in full at any point during the Plan Period, and some of the C stock distributed in the Distribution was acquired by D in exchange for Asset 1. See paragraph (b)(1)(ii)(A)(1) of this section. The Reflection of Basis Requirement is satisfied because that C stock had a basis prior to the Distribution that was determined in whole or in part by reference to the basis of Separated Property (Asset 1), and was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain on that C stock was recognized in full during the Plan Period prior to the Distribution. See paragraph (b)(1)(ii)(B) of this section. The Division of Relevant Property Requirement is satisfied because immediately after the Distribution, D continues to hold Relevant Property of P1 (Asset 2), and therefore, as part of a Plan, P1's Relevant Property has been divided between C and D. See paragraph (b)(1)(iii) of this section.

(C) Planned 50-percent Acquisitions of P1 and P2. Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of P1 as a result of the P1-P2 merger. In addition, under paragraph (d)(1)(i) of this section, Z is treated as acquiring stock representing 90% of the voting power and value of P2 in the P2-D merger. Accordingly, there have been Planned 50-percent Acquisitions of P1 and P2.

(D) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$100x of gain (\$200x of aggregate fair market value minus \$100x of aggregate basis of the C stock held by D), the Statutory Recognition Amount described in section 361(c)(2), because there have been Planned 50-percent Acquisitions of P1 and P2, both Predecessors of D. However, under paragraph (e) of this section, D's gain recognized by reason of the Planned 50-percent Acquisitions of P1 and P2 will not exceed \$60x, an amount equal to the amount D would have recognized had it transferred Asset 1 (Separated Property) to a newly formed corporation (C1) solely for stock and distributed the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. Under section 361(c)(2), D would recognize \$60x, an amount equal to the gain in the hypothetical C1 stock (excess of the \$100x fair market value over the \$40x basis). Paragraph (e)(1)(ii) of this section provides that if there are Planned 50-percent Acquisitions of multiple corporations, Distributing must recognize the Statutory Recognition Amount with respect to each such corporation, subject to the POD Gain Limitation Rule and the Distributing Gain Limitation Rule, if applicable. In this case, the POD Gain Limitation Rule limits the amount of gain required to be recognized by D with respect to each of the Planned 50-percent Acquisitions of P1 and P2 to \$60x. See paragraph (e)(2)(i) of this section. Ordinarily, each \$60x limitation would be added together, and the total gain limitation provided by paragraph (e) of this section would be \$120x. However, the anti-duplication rule set

forth in paragraph (e)(2)(ii)(C) of this section provides that, for purposes of applying the POD Gain Limitation Rule, a Predecessor of Distributing's Separated Property is taken into account only to the extent such property was not taken into account with respect to another Predecessor of Distributing. Thus, Asset 1 may not be taken into account more than once in determining the total gain limitation. Therefore, D recognizes \$60x of gain.

(8) Example 8: Multiple Predecessors of D--(i) Facts. X owns 100% of the stock of P1, which holds multiple assets, including Asset 1 and Asset 3. Y owns 100% of the stock of P2, which holds multiple assets, including Asset 2 and Asset 4. Z owns 100% of the stock of D. The following steps occur as part of a Plan: each of P1 and P2 merges into D in a reorganization under section 368(a)(1)(A). Immediately after the mergers, each of X and Y owns 10%, and Z owns 80%, of the stock of D. D then contributes to C Asset 1 (acquired from P1), and Asset 2 (acquired from P2). In exchange for Asset 1 and Asset 2, D receives additional C stock. D distributes the stock of C to X, Y, and Z, pro rata. D's contribution of Asset 1 and Asset 2 and the Distribution constitute a reorganization under section 368(a)(1)(D). D continues to hold Asset 3 and Asset 4. Immediately before the Distribution, Asset 1 has a basis of \$50x and a fair market value of \$110x, Asset 2 has a basis of \$70x and a fair market value of \$90x, and the stock of C held by D has a basis of \$130x and a fair market value of \$220x.

(ii) Analysis--(A) P1 and P2 are Predecessors of D. Under paragraph (b)(1) of this section, each of P1 and P2 is a Predecessor of D. First, each of P1 and P2 is a Potential Predecessor because, as part of a Plan, each of P1 and P2 transferred property to D in a Section 381 Transaction. See paragraph (b)(2)(ii)(A)(1) of this section. Second, both pre-Distribution requirements and the post-Distribution requirement are satisfied. The Relevant Property Requirement is satisfied because, immediately before the Distribution and as part of a Plan, C holds P1 Relevant Property (Asset 1) and P2 Relevant Property (Asset 2), the gain on each of which was not recognized in full at any point during the Plan Period, and some of the C stock distributed in the Distribution was acquired by D in exchange for each of Asset 1 and Asset 2. See paragraph (b)(1)(ii)(A)(1) of this section. The Reflection of Basis Requirement is satisfied because that C stock had a basis prior to the distribution that was determined in whole or in part by reference to the basis of Separated Property (Asset 1 and Asset 2, respectively), and was neither distributed in a distribution to which section 355(e) applied nor transferred in a transaction in which the gain on that C stock was recognized in full during the Plan Period prior to the Distribution. See paragraph (b)(1)(ii)(B) of this section. The Division of Relevant Property Requirement is satisfied because immediately after the Distribution, D continues to hold Relevant Property of P1 and P2, and therefore, as part of a Plan, each of P1's and P2's Relevant Property has been divided between C and D. See paragraph (b)(1)(iii) of this section.

(B) Planned 50-percent Acquisitions of P1 and P2. Under paragraph (d)(1)(i) of this section, Z is treated as acquiring stock representing 80% of the voting power and value of each of P1 and P2 as a result of the mergers of P1 and P2 into D. Accordingly, there have been Planned 50-percent Acquisitions of P1 and P2.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section,

D would be required to recognize \$90x of gain (\$220x of fair market value minus \$130x of basis of the C stock held by D), the Statutory Recognition Amount under section 361(c)(2). However, under the POD Gain Limitation Rule, D's gain recognized by reason of the Planned 50-percent Acquisition of P1 will not exceed \$60x (\$110x fair market value minus \$50x basis), an amount equal to the amount D would have recognized had it transferred Asset 1 (Separated Property) to a newly formed corporation (C1) solely for stock and distributed the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. See paragraph (e)(2)(i) of this section. In addition, under the POD Gain Limitation Rule, D's gain recognized by reason of the deemed acquisition of P2 stock will not exceed \$20x (\$90x fair market value minus \$70x basis), an amount equal to the amount D would have recognized had it transferred Asset 2 (Separated Property) to a second newly formed corporation (C2) solely for stock and distributed the C2 stock to D shareholders in a Hypothetical D/355(e) Reorganization. See paragraph (e)(2)(i) of this section. Therefore, D recognizes \$80x of gain (\$60x + \$20x). See paragraph (e)(1)(ii) of this section.

(9) Example 9: Successor of C--(i) Facts. X owns 100% of the stock of each of D and R. The following steps occur as part of a Plan: D distributes all of its C stock to X. Immediately before the Distribution, D's C stock has a basis of \$10x and a fair market value of \$30x. C then merges into R in a reorganization under section 368(a)(1)(D). Immediately after the merger, X owns all of the R stock. As part of the same Plan, Z acquires 51% of the stock of R from X.

(ii) Analysis--(A) R is a Successor of C. Under paragraph (c)(2)(i) of this section, R is a Successor of C because, after the Distribution, C transfers property to R in a Section 381 Transaction.

(B) Planned 50-percent Acquisition of C. Under paragraph (d)(2) of this section, Z's acquisition of stock of R is treated as an acquisition of stock of C. Therefore, Z is treated as acquiring 51% of the stock of C. Accordingly, there has been a Planned 50-percent Acquisition of C.

(C) Gain not limited. Section 355(e) applies to the Distribution because there has been a Planned 50-percent Acquisition of C. Neither the POD Gain Limitation Rule nor the Distributing Gain Limitation Rule applies because there has been no Planned 50-percent Acquisition of a Predecessor of D, and no Planned 50-percent Acquisition of D. Therefore, D recognizes \$20x of gain (\$30x fair market value minus \$10x basis of the C stock held by D) under section 355(c)(2).

(10) Example 10: Multiple Successors--(i) Facts. X owns 100% of the stock of both D and R. Y owns 100% of the stock of S. The following steps occur as part of a Plan: D distributes all of the C stock to X. Immediately after the Distribution, D merges into R in a reorganization under section 368(a)(1)(A) (D-R merger). Following the D-R merger, R merges into S in a reorganization under section 368(a)(1)(A) (R-S merger). Immediately after the R-S merger, X and Y own 10% and 90%, respectively, of the S stock. Immediately before the Distribution, D's C stock has a basis of \$10x and a fair

market value of \$30x.

(ii) Analysis--(A) R and S are Successors of D. Under paragraph (c)(2)(i) of this section, R is a Successor of D because, after the Distribution, D transfers property to R in a Section 381 Transaction. Under paragraph (c)(2)(ii) of this section, S is also a Successor of D because R (a Successor of D) transfers property to S in a Section 381 Transaction.

(B) Planned 50-percent Acquisition of D. Under paragraph (d)(1)(i) of this section, there is no deemed acquisition of D stock as a result of the D-R merger because X wholly owns the stock of D before the merger and wholly owns the stock of R after the merger. Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of R (a Successor of D) as a result of the R-S merger. Under paragraph (d)(2) of this section, an acquisition of R stock is also treated as an acquisition of D stock. Accordingly, there has been a Planned 50-percent Acquisition of D.

(C) Gain not limited. Section 355(e) applies to the Distribution because there has been a Planned 50-percent Acquisition of D. The POD Gain Limitation Rule does not apply because there has been no Planned 50-percent Acquisition of a Predecessor of D. The Distributing Gain Limitation Rule applies because there has been a Planned 50-percent Acquisition of D. However, the gain limitation under the Distributing Gain Limitation Rule equals the Statutory Recognition Amount, because there is no Predecessor of D (and thus no Separated Property). Therefore, D recognizes \$20x of gain (\$30x fair market value minus \$10x basis of the C stock held by D) under section 355(c)(2).

(i) Applicability date. This section applies to Distributions occurring after December 15, 2019. For Distributions occurring on or before December 15, 2019, see §1.355-8T as contained in 26 CFR part 1 revised as of April 1, 2019.

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Acting Deputy Commissioner for Services and Enforcement.

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David J. Kautter,

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